Better finances,
better lives

The Budget Plan 2000

Tabled in the House of Commons
by the Honourable Paul Martin, P.C., M.P.
Minister of Finance

February 28, 2000

Canada

Supplementary Information and
Notices of Ways and Means Motions Included

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Better finances, better lives

Introduction and Overview

This budget sets out the federal government's plan for Canada in the 21st century. The economy of today is global, increasingly knowledge-intensive and built on instant communication. The federal government's plan is designed to make Canada a leader in this new economy in order to increase the standard of living and the quality of life of all Canadians.

The plan is based on maintaining sound financial management, providing tax relief, building an innovative economy and investing in skills and knowledge to ensure Canadians have the tools they need for better jobs now and in the future. It strengthens post-secondary education and health care and helps children get the best possible start in life.

This budget provides:

- a $2.5-billion increase in the Canada Health and Social Transfer to help the provinces and territories fund post-secondary education and health care – the highest priorities of Canadians;
- a five-year tax reduction plan that will restore full indexation to the personal income tax system, cut core tax rates for the first time in 12 years, and reduce personal income taxes on an annual basis by an average of 15 per cent by 2004-05. The Plan will reduce taxes by a cumulative amount of at least $58 billion over the next five years; and

- a series of initiatives, totalling $4.1 billion between 1999-2000 and 2002-03, to promote innovation and leading-edge research, develop environmental technologies and practices, and strengthen federal, provincial and municipal infrastructure.

The actions set out in this budget to improve the quality of life of Canadians and their children are part of an overall four-part plan:

Maintaining Sound Financial Management

The Government is committed to low inflation, balanced or surplus budgets and a declining public debt burden. These are fundamental conditions for sustained economic growth and job creation, which in turn enable the Government to make investments in key priorities and provide substantial tax relief.

Providing Tax Relief

The Government believes that tax reduction is essential to improving living standards. It increases productivity, creates jobs and leaves more money in the pockets of Canadians.

Making Canada's Economy More Innovative

In the modern global economy, the nations that thrive will be those that excel at innovation. That is why the Government is increasing its support for the kind of groundbreaking research that will provide new ideas, products and services and generate continued economic growth in Canada.

Investing in Skills and Knowledge

Skills and knowledge are the best guarantees of higher incomes, greater job security and expanding opportunity for all Canadians. The Government is increasing its support of university research and providing further tax assistance to students on scholarships.

Maintaining Sound Financial Management

The Government's commitment to sound financial management – maintaining low inflation, keeping the budget in balance or surplus and reducing the debt burden – has allowed the Canadian economy to expand at a healthy pace and exceed the expectations of virtually all forecasters.

Economic Outlook Is for Continued Strong Growth

The economy grew strongly in 1999, with real GDP growth estimated to have averaged 3.8 per cent.

Private sector forecasters expect continued robust economic growth in 2000 and 2001.

Both the International Monetary Fund and the Organisation for Economic Co-operation and Development expect Canada to post the second fastest economic growth among the Group of Seven (G-7) major industrial countries in 2000 and to lead in job creation.

Unemployment Rate at Its Lowest Level in 24 Years

Last year marked the third consecutive year of strong job growth, with 427,000 jobs created during the year and almost 1.3 million jobs created since the end of 1996.

By the end of 1999, the unemployment rate was down to 6.8 per cent, its lowest level in almost 24 years.

Increase in Disposable Income

The strong job market performance has contributed to solid personal income growth. Real after-tax income improved for the third consecutive year in 1999. It has risen about 3 per cent in per capita terms since 1996, and private sector forecasters project that it will continue to increase significantly in the years ahead.

Sustained Low Inflation

Inflation has picked up somewhat in recent months, mainly reflecting higher fuel prices due to a strong increase in world oil prices. In December 1999, the year-over-year consumer price index inflation rate was 2.6 per cent while the inflation rate (which excludes the impact of food and energy) was 1.6 per cent. Inflation is expected to return to the mid-point of the 1-to-3 per cent target band set jointly by the Government and the Bank of Canada.

Strong Consumer and Business Confidence

Domestic demand has been buoyed by strong employment and income growth, which, together with low interest rates, have boosted consumer confidence. Business confidence has bounced back sharply since the end of 1998 and is now equal to the record high reached in mid-1997.

Budget 2000 Delivers:

Balanced Budgets or Better

- A balanced budget or better is expected for 1999-2000. The Government is committing to balanced budgets or better in 2000-01 and 2001-02. This would be the first time in 50 years that the budget has been in surplus or balance for five consecutive years. In fact, since Confederation there have been only two other occasions when the Government of Canada recorded balanced budgets or better at least five years in a row.

Continued Prudent Approach to Budget Planning

- The Government will continue to follow its prudent and transparent approach to budget planning. In accordance with the Debt Repayment Plan, it will continue to use the Contingency Reserve to reduce public debt in those years when it is not required.

Debt Burden

- The Debt Repayment Plan and sustained economic growth will ensure that the debt-to-GDP ratio – the level of the debt in relation to the country's annual income – remains on a permanent downward track. From a post-World War II peak of 71.2 per cent in 1995-96, it is expected to fall to about 55 per cent by 2001-02 and to below 50 per cent by 2004-05.

Controlling Spending

- From 1997-98, when the budget was first balanced, to 2001-02, the growth in program spending will be held to roughly the growth in population and inflation. As a percentage of GDP, it is projected to fall to 11.6 per cent in 2001-02 from 12.4 per cent in 1997-98 – the lowest ratio in half a century. Total program spending in the coming year will be $4 billion below the 1993-94 level.

- Since the federal budget was balanced, fully two-thirds of all new spending has been directed towards health, access to knowledge and skills, and innovation.

International Perspective

- By the accounting standards used in most other G-7 countries, the federal government will post a financial surplus for the fourth consecutive year in 1999-2000 – the only G-7 country to do so.

- Canada recorded the largest improvement in its financial balance of all G-7 countries from 1992 to 1999.

Five-Year Tax Reduction Plan

In the fall of 1999, the Government promised Canadians in both the Speech from the Throne and *The Economic and Fiscal Update* that it would set out a multi-year plan for further tax reductions. With significant planning surpluses now available, this budget delivers on that commitment by making the most important structural changes to the Canadian federal tax system in more than a decade, with a special emphasis on the needs of families with children.

Five-Year Tax Reduction Plan Delivers:

Personal Income Taxes

Full Protection Against Inflation in the Tax System

- In a fundamental break with the past, the Five-Year Tax Reduction Plan immediately restores full indexation of the personal income tax system to protect taxpayers against inflation – this will benefit every Canadian.
- Full indexation will stop the automatic tax increases and benefit erosion that have occurred under Canada's tax system since the mid-1980s. For example, the real value of benefits such as the Canada Child Tax Benefit and the goods and services tax credit will no longer be eroded by inflation.

Reduction in Personal Income Tax Rates

- For the first time in 12 years, a federal income tax rate – the middle tax rate – will be lowered. The Plan reduces the middle tax rate to 23 per cent from 26 per cent, starting with a two-point reduction to 24 per cent in July 2000. This will cut taxes for 9 million Canadians.

Increases in Income Thresholds at Which Personal Income Tax Rates Apply

- Canadians will be able to earn more income tax-free and more of their income will be taxed at lower rates.
- The Plan increases the amount of income Canadians can receive tax-free to at least $8,000 and the income amounts where middle and upper tax rates begin to apply to at least $35,000 and $70,000 respectively.

Enrichment of Canada Child Tax Benefit

- The Plan enriches the Canada Child Tax Benefit so that by 2004 an additional $2.5 billion annually will be provided to low- and middle-income families with children. This will bring total benefits to more than $9 billion annually. Maximum benefits will rise to $2,400 for a first child and $2,200 for a second child.

Elimination of the Deficit Reduction Surtax

- The Plan eliminates, as of July 1, 2000, the 5-per-cent deficit reduction surtax on middle-income Canadians with incomes up to about $85,000, and completely eliminates it by 2004.

Investments in RPPs and RRSPs

- The Plan raises to 25 per cent for 2000 and to 30 per cent for 2001 the permissible foreign content of investments in registered pension plans and registered retirement savings plans.

Encouraging Innovation and Investment

The Five-Year Tax Reduction Plan will also help Canada become more competitive internationally by making the tax system more conducive to investment and innovation.

Reduce Corporate Income Tax Rates

- The Plan reduces corporate tax rates to 21 per cent from 28 per cent for businesses in the highest taxed sectors, such as high-technology services, to make these businesses more internationally competitive. The reduction starts with a one-point cut effective January 1, 2001.

Reduce Small Business Tax

- The Plan will reduce the general corporate tax rate to 21 per cent from 28 per cent on small business income between $200,000 and $300,000 effective January 1, 2001.

Enhance Tax Treatment of Capital Gains

- To stimulate risk-taking and greater access to financing for small businesses, the Plan:
  - reduces the capital gains inclusion rate from three-quarters to two-thirds;
  - postpones the taxation of gains on qualifying stock options to when the shares are sold rather than when the options are exercised; and
  - allows a tax-free rollover of capital gains on qualified investments from one small business to another.

Tax Plan Impacts

The Plan will reduce taxes by a cumulative amount of at least $58 billion over the next five years.

On an annual basis, the Plan will reduce personal income taxes by an average of 15 per cent by 2004-05.

- For low- and middle-income Canadians, the Plan will reduce net personal income taxes by an average of 18 per cent.
- For families with children, the Plan will reduce net personal income taxes by an average of 21 per cent.
- A typical one-earner family of four with about $35,000 of income will pay no net federal personal income tax.
- A typical one-earner family of four with income of $40,000 will have its net federal personal income taxes reduced by $1,623 a year by 2004 – a reduction of 48 per cent.
- A typical two-earner family of four with income of $60,000 will have its net federal personal income taxes reduced by $1,546 a year by 2004 – a reduction of 27 per cent.

Making Canada's Economy More Innovative

This budget proposes initiatives totalling $4.1 billion between 1999-2000 and 2002-03 to promote leading-edge research and innovation in universities, research hospitals and the private sector; to develop new environmental technologies and improve environmental practices; and to strengthen federal, provincial and municipal infrastructure.

Investing in Innovation, Knowledge and Skills

The budget builds on the Canadian Opportunities Strategy introduced in the 1998 budget and expanded in the 1999 budget. It:

- provides $900 million over five years to establish and sustain 2,000 new university research chairs across Canada;
- provides a further $900 million to the Canada Foundation for Innovation, bringing the Government's total investment in the Foundation to $1.9 billion;
- invests $160 million in Genome Canada to advance the study of genes and biotechnology, especially their application to priority areas like health;
- invests $90 million over three years for federal departments and agencies that regulate biotechnology products and processes; and
- increases the tax exemption for income from scholarships, fellowships and bursaries to $3,000 from $500.

Promoting Environmental Technologies and Practices

- The Government will allocate $700 million between 1999-2000 and 2002-03 to develop new environmental technologies and improved practices in co-operation with provinces, municipalities, the private sector and non-governmental organizations.
- The budget proposals include a renewed Climate Change Action Fund, the Sustainable Development Technology Fund, a new Canadian Foundation for Climate and Atmospheric Sciences, new municipal-based initiatives for clean air and water, a National Strategy on Species at Risk and the Great Lakes Action Plan.

Strengthening Federal, Provincial and Municipal Infrastructure

- The federal government will renew its own infrastructure and work with other orders of government and the private sector to reach an agreement by the end of 2000 on a multi-year plan to improve provincial highways and municipal infrastructure in cities and rural communities across Canada.

Improving the Quality of Life of Canadians and Their Children

Increased Support for Post-Secondary Education and Health Care

■ Canada Health and Social Transfer (CHST) payments will be increased by $2.5 billion to help the provinces and territories fund post-secondary education and health care.

■ This is the fourth consecutive federal enhancement to the CHST. They can draw upon this new funding to meet the most pressing needs in universities and hospitals, or at any time over the next four years, as they see fit.

■ Starting in 2000-01, CHST cash will reach $15.5 billion – a 25-per-cent increase over the last two years.

■ Total CHST (cash and tax transfers combined) will reach an all-time high of almost $31 billion in 2000-01.

Support for Families With Children

■ The Canada Child Tax Benefit will be increased by $2.5 billion a year by 2004, bringing to more than $9 billion its annual support for low- and middle-income families with children. This will mean a maximum benefit of $2,400 for a family's first child and $2,200 for a second child.

■ The duration of employment insurance maternity and parental leave will double to 12 months, giving new parents the opportunity to spend more time with their newborn or newly adopted children.

■ The federal government reiterates its invitation from last fall's Speech from the Throne to provincial and territorial governments to reach an agreement by December 2000 on an action plan to support early childhood development.

Assistance for Canadians With Disabilities

■ Building on previous budget measures, the federal government will extend support and implement additional tax initiatives to expand opportunities for persons with disabilities and help them deal with medical and care-related costs.

Summary of Spending and Tax Actions

Table 1.1 presents the fiscal outlook to 2001-02, taking into account all of the spending and tax measures announced since the 1999 budget.

Table 1.2 presents the fiscal impact of the spending and tax initiatives announced in this budget, Table 1.3 presents the fiscal impact of the measures announced before the budget while Table 1.4 shows the total fiscal impact of the spending and tax measures proposed since the 1999 budget. The cost of these proposed spending and tax actions amounts to $6.2 billion in 1999-2000, $7.7 billion in 2000-01, $12.0 billion in 2001-02 and $14.6 billion in 2002-03.

During the four years from 1999-2000 to 2002-03, the cost of the spending and tax actions proposed since the 1999 budget will amount to $40.4 billion (Table 1.4).

Of this amount, $16.8 billion is for spending initiatives. This includes $2.5 billion for the CHST; $4.1 billion for research, innovation, environmental initiatives and infrastructure; and $1.7 billion for economic adjustments, primarily further farm assistance.

The tax relief measures legislated through this budget, including the assumed reductions in employment insurance premiums, amount to $23.6 billion over this fiscal year and the following three years.

Table 1.1
Summary Statement of Transactions: The Two-Year Planning Horizon

	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002
	(billions of dollars)				
Budgetary transactions					
Budgetary revenues	153.2	155.7	160.0	162.0	168.0
Program spending	108.8	111.4	115.5	116.0	121.5
Operating balance	44.4	44.3	44.5	46.0	46.5
Public debt charges	40.9	41.4	41.5	42.0	41.5
Underlying budgetary balance	3.5	2.9	3.0	4.0	5.0
Prudence					
Economic prudence				1.0	2.0
Contingency Reserve			3.0	3.0	3.0
Total			3.0	4.0	5.0
Budgetary balance	**3.5**	**2.9**	**0.0**	**0.0**	**0.0**
Net public debt	579.7	576.8	576.8	576.8	576.8
Non-budgetary transactions	9.3	8.6	8.0	-5.0	0.0
Financial requirements/surplus	12.7	11.5	8.0	-5.0	0.0
Percentage of GDP					
Budgetary revenues	17.5	17.4	16.9	16.2	16.1
Program spending	12.4	12.4	12.2	11.6	11.6
Public debt charges	4.7	4.6	4.4	4.2	4.0
Total expenditures	17.1	17.1	16.6	15.8	15.6
Budgetary balance	0.4	0.3	0.0	0.0	0.0
Net public debt	66.3	64.4	61.1	57.8	55.2
Financial requirements/surplus	1.5	1.3	0.8	-0.5	0.0

Note: Numbers may not add due to rounding.

Table 1.2
Spending and Tax Initiatives Announced in the 2000 Budget

	1999-2000	2000-2001	2001-2002	2002-2003	Cumulative total
	(millions of dollars)				
Spending initiatives announced in this budget					
Improving the quality of life for Canadians and their children					
Post-secondary education and health care[1]	2,500				2,500
Support for families with children			607	965	1,572
Opportunities for Canadians with disabilities		33	37	32	102
Total	2,500	33	643	997	4,173
Making Canada's economy more innovative					
Investing in research and innovation	1,095	208	278	268	1,849
Promoting environmental technologies and practices	235	148	143	159	685
Strengthening federal, provincial and municipal infrastructure		300	550	750	1,600
Total	1,330	656	971	1,177	4,134
Maintaining essential public services					
Defence	350	400	550	600	1900
Furthering international co-operation	175	110	155	200	640
Operating and capital	118	795	834	760	2,506
Total	643	1,305	1,539	1,560	5,046
Total spending initiatives	**4,473**	**1,994**	**3,153**	**3,733**	**13,353**
Tax initiatives announced in this budget					
Personal tax relief		2,835	4,600	5,830	13,265
Canada Child Tax Benefit		475	1,020	1,350	2,845
Corporate income tax		5	390	545	940
Reduction in employment insurance premiums[2]		235	1,010	1,805	3,050
Tax fairness measures		15	40	45	100
Total		**3,565**	**7,060**	**9,575**	**20,199**
Total spending and tax initiatives announced in this budget	**4,473**	**5,559**	**10,213**	**13,308**	**33,552**

[1] CHST supplement in 1999-2000 will be paid to a third-party trust in 2000-01, on passage of authorizing legislation. Expected drawdown by provinces and territories is described in Chapter 6.

[2] For planning purposes, employee EI premium rates are assumed to decline by 10 cents in 2001, 2002 and 2003. Actual rates are set each year by the Employment Insurance Commission.

Note: Numbers may not add due to rounding.

Table 1.3
Spending and Tax Initiatives Announced Before the 2000 Budget

	1999-2000	2000-2001	2001-2002	2002-2003	Cumulative total
	(millions of dollars)				
Spending initiatives announced before the budget					
Improving the quality of life for Canadians and their children					
Assisting the homeless	63	235	220	220	738
Maintaining essential public services					
Defence	284	146			429
Economic adjustment	661	511	500		1,672
Operating and capital	387	205			592
Total	1,331	862	500		2,693
Total spending initiatives	**1,394**	**1,097**	**720**	**220**	**3,430**
Tax initiatives announced before the budget					
Reduction in EI premium rates	345	1,157	1,165	1,175	3,841
Tobacco taxes	-25	-140	-140	-140	-445
Total	**320**	**1,017**	**1,025**	**1,035**	**3,396**
Total spending and tax initiatives announced before this budget	**1,713**	**2,114**	**1,745**	**1,255**	**6,826**

Note: Numbers may not add due to rounding.

Table 1.4
Summary: Spending and Tax Initiatives Since the 1999 Budget

	1999-2000	2000-2001	2001-2002	2002-2003	Cumulative total
			(millions of dollars)		
Spending initiatives					
Improving the quality of life for Canadians and their children					
Post-secondary education and health care	2,500				2,500
Support for families with children			607	965	1,572
Opportunities for Canadians with disabilities		33	37	32	102
Assisting the homeless	63	235	220	220	738
Total	2,563	268	863	1,217	4,911
Making Canada's economy more innovative					
Investing in research and innovation	1,095	208	278	268	1,849
Promoting environmental technologies and practices	235	148	143	159	685
Strengthening federal, provincial and municipal infrastructure		300	550	750	1,600
Total	1,330	656	971	1,177	4,134
Providing essential public services					
Defence	634	546	550	600	2,329
Furthering international co-operation	175	110	155	200	640
Economic adjustment	661	511	500		1,672
Operating and capital	505	1,000	834	760	3,098
Total	1,974	2,167	2,039	1,560	7,739
Total spending initiatives	**5,867**	**3,091**	**3,873**	**3,953**	**16,783**
Tax initiatives					
Personal tax relief		2,835	4,600	5,830	13,265
Canada Child Tax Benefit		475	1,020	1,350	2,845
Corporate income tax		-65	320	475	730
Reduction in EI premiums	345	1,392	2,174	2,980	6,890
Tax fairness measures	-25	-55	-30	-25	-135
Total	320	4,582	8,084	10,610	23,595
Total spending and tax initiatives	**6,186**	**7,672**	**11,957**	**14,563**	**40,378**

Note: Numbers may not add due to rounding.

2

Better finances, better lives

Economic Developments and Prospects[1]

Highlights

- The Canadian economy grew strongly in 1999, surpassing forecasters' expectations. This led to significant gains in incomes and job creation.
- By the end of 1999, the unemployment rate was down to 6.8 per cent, its lowest level in nearly 24 years. This marks the third consecutive year of strong job growth, with almost 1.3 million new jobs created from the end of 1996 to January 2000.
- Private sector forecasters expect economic growth to continue at a healthy pace in 2000 and 2001.
- Both the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD) expect Canada to post the second fastest economic growth among the Group of Seven major industrial countries in 2000 and to lead in job creation.

[1] Includes data up to February 11, 2000. National economic and financial accounts data for the fourth quarter of 1999, released on February 28, 2000, are not included.

Introduction

In 1999, the Canadian economy rebounded strongly from the slow growth in mid-1998 caused by the financial and economic crisis that began in Asia in 1997 and then spread to Russia and Latin America. Since late 1998, the Canadian economy has expanded at a healthy pace, exceeding the expectations of all forecasters surveyed. Real gross domestic product (GDP) growth in 1999 is estimated to have averaged 3.8 per cent.

This resilience reflects the Government's commitment to sound economic and financial policies – low inflation and balanced budgets. Strong fundamentals supported a rapidly strengthening domestic economy, which in turn helped to sustain Canada's economic performance during the recent period of economic and financial turbulence.

As well, solid fundamentals have enabled Canada to take advantage of improving international economic conditions. Continued strong growth in the United States, accelerating economic growth in Europe and economic recovery in Asia have contributed to the rebound in the Canadian economy.

As a result, Canadian economic growth is forecast to remain healthy in 2000 and 2001, although at a slightly slower pace than in 1999, reflecting an expected slowing in the U.S. economy. On average, private sector forecasters now predict that real GDP growth will be 3.5 per cent in 2000 and 2.9 per cent in 2001.

Recent Economic Developments

World Economy

There is growing evidence of a widespread and increasingly balanced recovery in global growth, coming considerably earlier than expected. The OECD estimates world economic growth to have risen sharply to 3.0 per cent in 1999, from 2.2 per cent in 1998. Among major economies, the U.S. has continued to post strong growth in output and productivity while still showing few signs of wage and price pressures, even though its unemployment rate remains at a 30-year low.

While the U.S. economy has continued to act as the locomotive of the global economy, hopeful signs are emerging that conditions are strengthening in other major economies, particularly in Europe.

A number of Asian economies have also embarked on strong recoveries, reflecting the earlier lowering of interest rates globally, as well as their implementation of essential financial and economic reforms. In reaction to these developments, as well as some supply factors, energy prices have risen significantly and other commodity prices have begun to pick up.

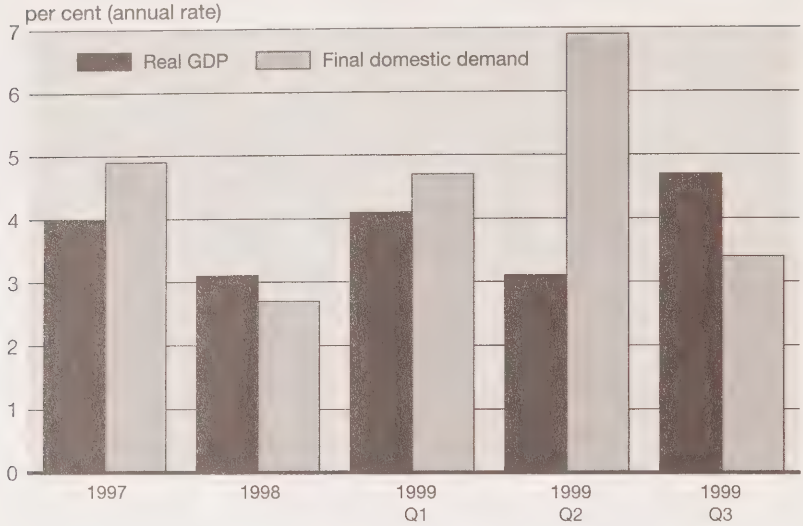
With global economic conditions improving earlier and more than expected, major central banks have started to raise interest rates from the low levels required when financial instability posed a significant risk of a global economic downturn. But despite the recent increases, interest rates remain supportive of global growth.

Canadian Economy

Global financial market turmoil led to a spike in Canadian interest rates in August 1998. Canada's low inflation and strong fiscal performance, however, meant that the increase in interest rates was quickly unwound as financial market confidence was restored. As a result, Canada experienced only a modest slowdown in growth in 1998 despite the sharp deterioration in world economic conditions. Moreover, Canada's strong fundamentals meant that the economy was well positioned to take advantage of the improvement in international economic conditions that began in late 1998.

The economy consistently outpaced private sector forecasters' expectations by a wide margin through 1999. Growth strengthened in 1999 and reached 4.7 per cent in the third quarter. Growth is now estimated by private sector forecasters to have averaged 3.8 per cent in 1999, almost double the average forecast at the time of the 1999 budget. The rebound in growth was fuelled by a combination of a stronger international economy, most notably continuing strong growth in the U.S., stronger commodity prices and improving domestic demand. The surge in domestic demand (Chart 2.1) reflects Canada's low interest rates, improved confidence and strong employment growth.

Chart 2.1
Real GDP and Final Domestic Demand Growth

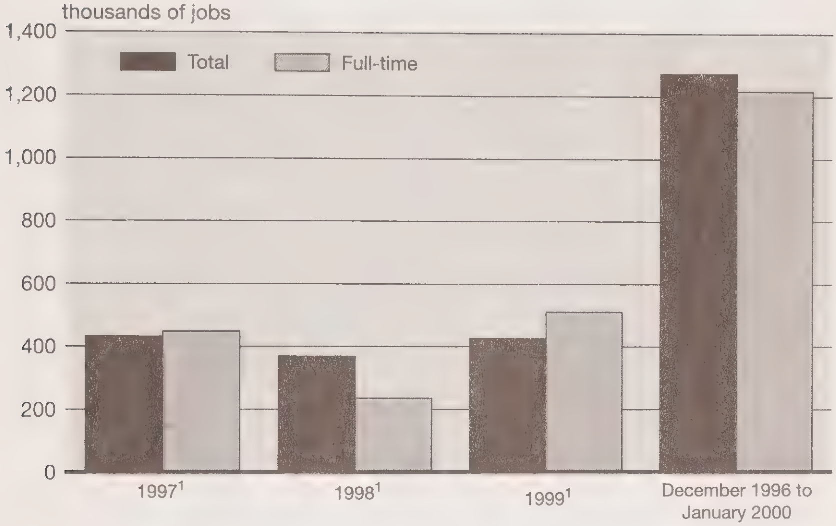


Ongoing solid economic growth has contributed to strong job creation in Canada (Chart 2.2), with almost 1.3 million jobs created from December 1996 to January 2000. The pace of job creation in Canada over this period has been almost double that in the U.S. Of this total, some 427,200 jobs were added in 1999, all of them full-time, with solid gains in all regions of the country (Chart 2.3). Another 44,300 jobs were added in January. Youth employment has increased strongly: it is up almost 230,000 since the end of 1997 – an average annual growth rate of over 5 per cent.

The unemployment rate dropped more than one percentage point through 1999. By December, the sustained strength of job creation had brought the unemployment rate down to 6.8 per cent, its lowest level since April 1976 (Chart 2.4).

Chart 2.2

Employment Growth



[1]December to December.

Chart 2.3

Regional Employment Growth
From December 1998 to December 1999

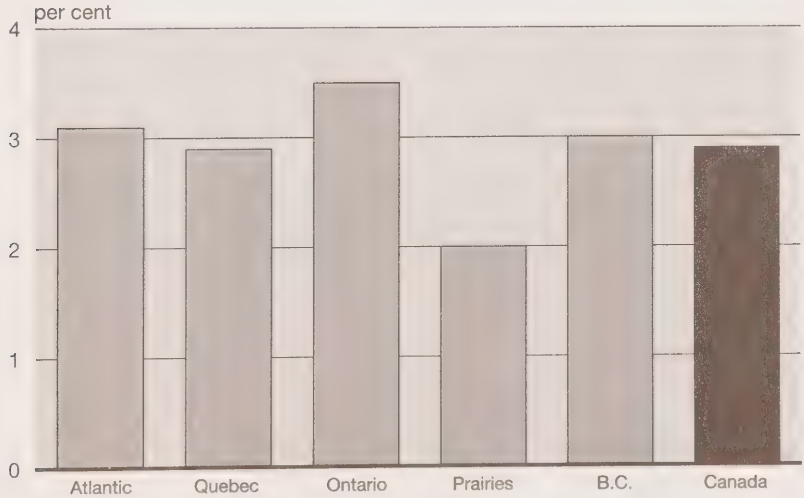
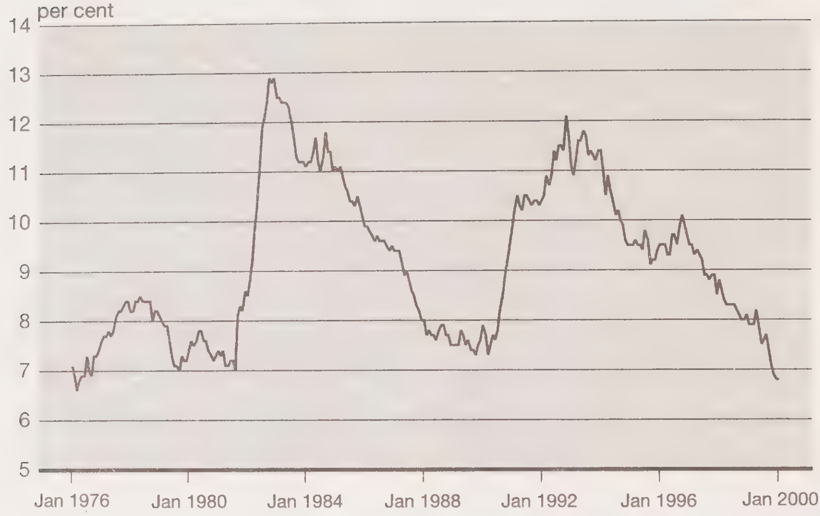
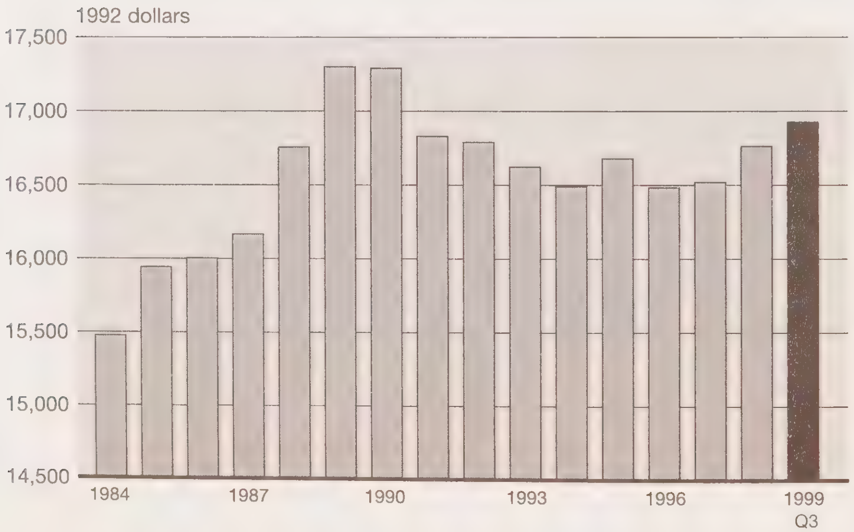


Chart 2.4
Unemployment Rate



The sustained strong job-market performance has contributed to solid personal income growth. Indeed, the inflation-adjusted after-tax income of Canadians has increased steadily since 1996, rising almost 3 per cent and recovering more than half of the loss that occurred in the first half of the 1990s (Chart 2.5).

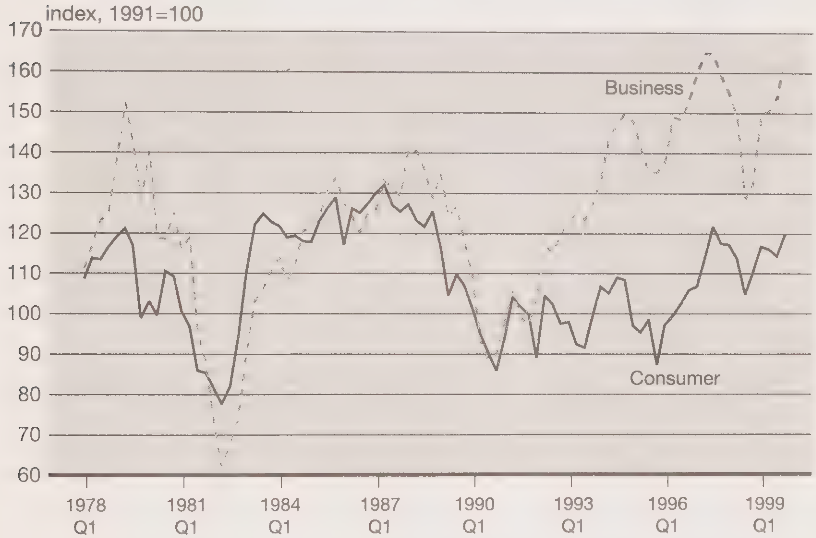
Chart 2.5
Real Per Capita Disposable Income



In turn, domestic demand has been buoyed by strong employment and income growth which, together with low interest rates, have boosted consumer and business confidence (Chart 2.6). Consumer confidence increased strongly in 1999, rebounding to near its 1997 peak. Business confidence has also bounced back sharply since the end of 1998 and is now almost equal to the record high reached in the second quarter of 1997.

Chart 2.6

Consumer and Business Confidence



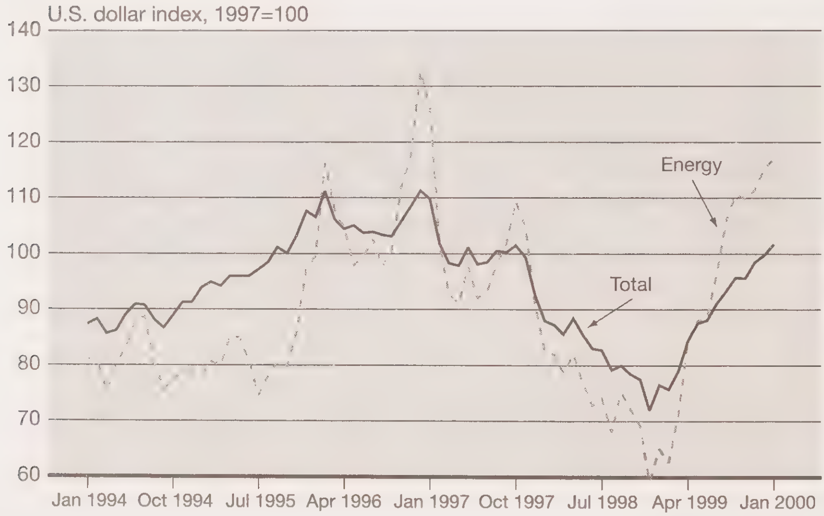
With substantial income growth generated by a healthy labour market, consumer spending rebounded strongly after stalling at the end of 1998, growing over 4 per cent in each of the first three quarters of 1999. Spending on consumer durables, such as automobiles, was particularly strong. Residential investment also surged in 1999, with growth in spending on new construction averaging 12.6 per cent over the first nine months, while home resales hit their highest level in two and a half years in the second quarter of 1999.

Business investment, which had slowed noticeably in 1998 in response to the Asian crisis, also contributed to the pickup in economic activity, particularly during the first half of the year. This resurgence reflected renewed confidence and improved profitability, as well as spending by Canadian firms to ensure Y2K computer

compliance. In the third quarter, however, business investment slowed as machinery and equipment spending fell slightly, reflecting in part a tapering off of growth in spending on computers and office equipment.

Strong U.S. growth, combined with economic recovery in Asia, has contributed to a rebound in commodity prices back to the levels recorded before the onset of the Asian crisis (Chart 2.7). Energy prices in particular have bounced back sharply, boosted by low world inventories and stricter adherence to production quotas by the Organization of the Petroleum Exporting Countries. Non-energy commodity prices, such as the price for base metals, have also recovered, reflecting the improvement in world economic conditions. Some agricultural commodity prices, however, remain low.

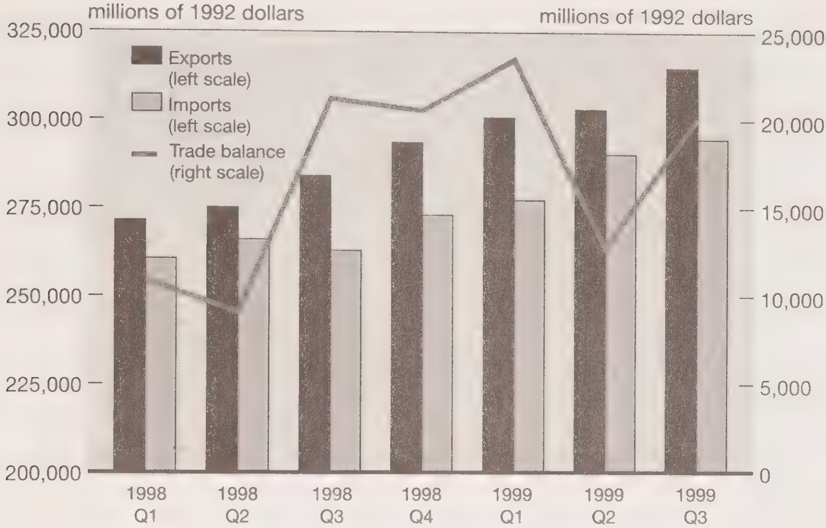
Chart 2.7
Commodity Prices



Higher commodity prices have boosted aggregate export prices relative to import prices – otherwise described as an improvement in the terms of trade. As well, the continued strength of the U.S. economy has made an important direct contribution to Canadian growth, leading to a strong improvement in the real trade balance. It surged in the third quarter due to broad-based strength in exports, particularly exports of automotive products and machinery and equipment to the U.S. (Chart 2.8).

Chart 2.8

Real Merchandise Exports, Imports and Trade Balance



Canada's improved international competitiveness vis-à-vis the U.S. also contributed to the improvement in the trade balance. Continued productivity growth, together with moderate wage gains consistent with Canada's low inflation performance, has resulted in slower growth in unit labour costs in Canada than in the U.S. (Chart 2.9).

The improvement in the trade balance swung the current account into surplus in the third quarter of 1999 for the first time since 1996 (Chart 2.10). In 1997 and 1998, the current account deficit – which corresponds to an increase in Canada's net foreign indebtedness – averaged about $15 billion or 1.7 per cent of GDP. But since the beginning of 1999, the current account has improved significantly and is expected to remain close to balance. Canada's net foreign indebtedness fell from a peak of nearly 45 per cent of GDP in 1993 to 36 per cent in 1998, and is estimated to have fallen again last year, imposing a far smaller burden on Canadian living standards (Chart 2.11).

Chart 2.9

Canada-U.S. Relative Unit Labour Costs

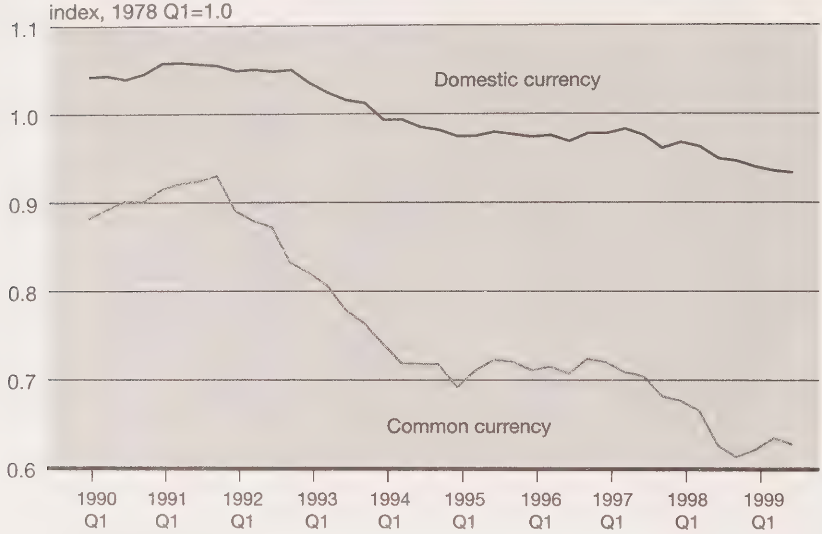


Chart 2.10

Current Account Balance

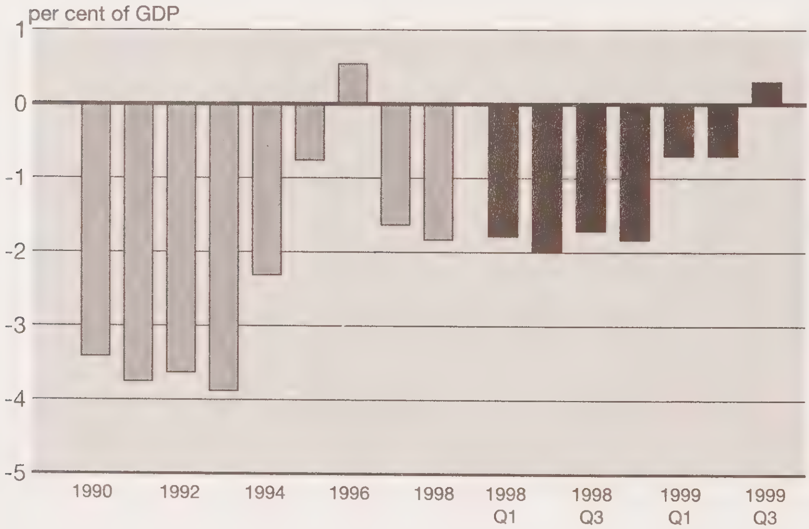
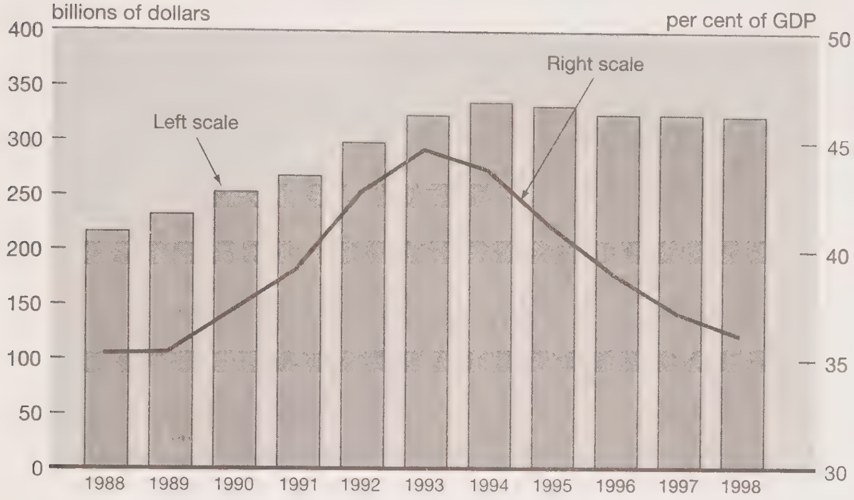


Chart 2.11
Net Foreign Indebtedness



Consumer price inflation increased only modestly in 1999 and remains subdued. The rise was mainly due to the impact of earlier declines in the value of the Canadian dollar (which over time boosts import costs) and higher energy prices, reflecting the doubling of world oil prices over the past year. In December 1999, the year-over-year consumer price index (CPI) inflation rate was 2.6 per cent while the inflation rate (which excludes the impact of food and energy) was 1.6 per cent, just under the middle of the 1-to-3 per cent inflation control target band set jointly by the Government and the Bank of Canada (Chart 2.12).

Producer price growth, as measured by the GDP deflator, also increased in 1999, after having been negative (-0.6 per cent) in 1998. In the first three quarters of 1999, the GDP deflator was 1.2 per cent higher than its 1998 average level. The pickup was mainly due to higher prices for Canadian exports.

Sustained low inflation coupled with a solid fiscal performance brought Canadian interest rates down substantially in recent years from their mid-1990s levels. After rising sharply in response to the fallout from the Asian crisis, short-term interest rates fell again in early 1999, as the Bank of Canada cut the Bank Rate 25 basis points in March and again in May. Since then, stronger-than-expected global growth and fears of an emergence of inflationary pressures in the U.S. have put upward pressure on interest rates – the Bank Rate increased 25 basis points in

November. Those pressures have intensified since December in light of further evidence that the U.S. economy was continuing to grow much faster than expected. As a result, both short- and long-term rates have moved up in the U.S. and Canada – the Bank Rate increased 25 basis points in early February. However, Canadian rates remain well below their recent peaks in 1995 (Chart 2.13) and are still below U.S. rates at all maturities.

Chart 2.12

Consumer Price Inflation

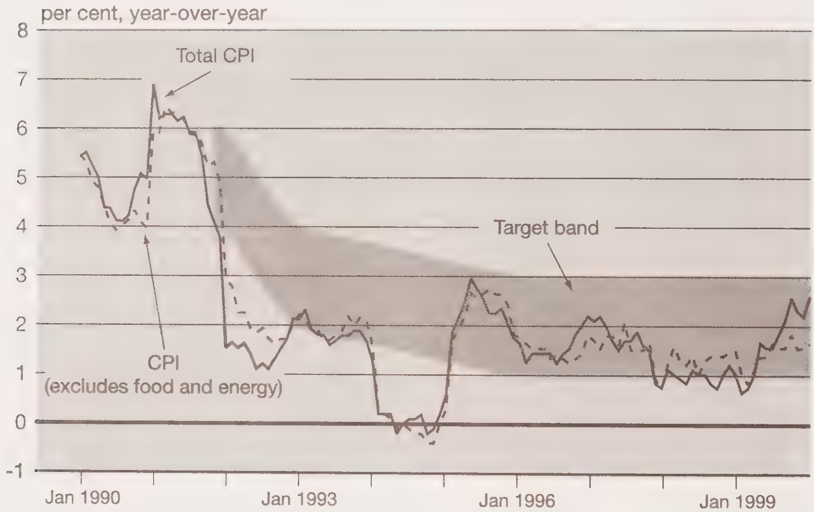
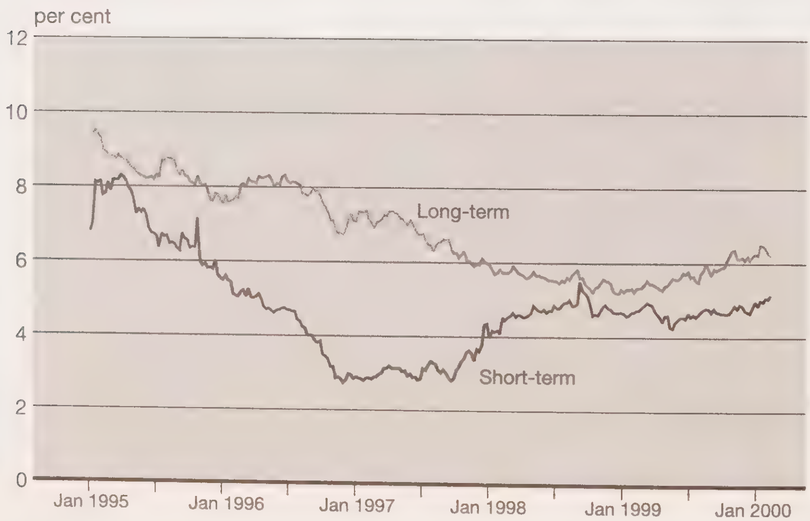


Chart 2.13

Interest Rates



The Economic Outlook and Risks

External Environment

Overall economic conditions in both the overseas economies and the U.S. are anticipated to remain conducive to growth and job creation in Canada in the coming years. The OECD forecasts that world growth will increase from 3 per cent in 1999 to average about 3.5 per cent in 2000 and 2001 (Table 2.1). This is forecast to result in some upward movement in world interest rates. As expected, major central banks started to raise interest rates earlier this year.

Table 2.1
Global Outlook for Real GDP Growth

	1998	1999	2000	2001
		(per cent)		
World	2.2	3.0	3.5	3.4
Japan	-2.8	1.4	1.4	1.2
Germany	2.2	1.3	2.3	2.5
France	3.4	2.4	3.0	2.9
United Kingdom	2.2	1.7	2.7	2.3
Italy	1.3	1.0	2.4	2.7

Source: *OECD Economic Outlook*, December 1999.

Overseas Economies

All of the major European economies are expected to post solid growth during the next two years, following a temporary slowdown in 1999. With real growth in these countries forecast to strengthen significantly in 2000, prospects are for European interest rates to rise somewhat over the next two years.

Economic conditions in Japan are projected to remain steady over the next two years, with forecast real GDP growth virtually unchanged from its modest pace in 1999. Renewed weakness in the Japanese economy in late 1999 highlights the risks to a domestically led recovery in Japan, particularly given the transition costs related to ongoing structural reforms.

United States

The U.S. economy continued to post strong growth in 1999, with little sign of any increase in underlying inflation. Real U.S. GDP growth is estimated to have averaged 4 per cent in 1999, maintaining the same robust pace for a third successive year

(Table 2.2). The Blue Chip survey of U.S. forecasters calls for a gradual slowing in real growth in the near term, reflecting a slowdown in spending on interest-sensitive components of demand, such as housing and consumer durables, due to higher interest rates. Real GDP growth is now forecast to fall to 3.6 per cent in 2000 and to 3.0 per cent in 2001, a more modest slowdown than expected last autumn.

Table 2.2
U.S. Outlook: Blue Chip Forecast

	1999[1]	2000	2001
		(per cent)	
Real GDP growth	4.0	3.6	3.0
CPI inflation	2.2	2.5	2.5
3-month Treasury bill rate	4.6	5.6	5.6
10-year government bond rate	5.6	6.4	6.3

Source: *Blue Chip Economic Indicators*, January 2000.
[1] Final estimates, except for real GDP growth.

This "soft landing" outlook is consistent with the view that moderate increases in interest rates will be required following those over the last year to slow domestic demand to a more sustainable pace.

Canada's Economic Prospects

The favourable global economic prospects and healthy domestic conditions brighten Canada's near-term economic outlook. Building on the momentum established in 1999, the Canadian economy is expected to be led by domestic demand over the near term. Continued low and stable inflation and sound public finances, as reflected in falling government debt and tax burdens, are working together to reinforce this positive outlook.

Moreover, the benefits for Canada of a stronger world economy and the resulting support for commodity prices – combined with firm domestic demand – should also help offset much of the negative impact of the expected slowing in the U.S. economy. As a result, Canada is poised to enjoy continued healthy growth over the near term in spite of the upward drift in interest rates around the world.

Average Private Sector Forecast

Consistent with improving domestic and global economic conditions, private sector forecasters have made significant upward revisions throughout the past year to their expectations of economic growth, inflation and interest rates. Real GDP growth is now estimated to have increased significantly from 3.1 per cent in 1998 to 3.8 per cent in 1999 (Table 2.3).

The December 1999 survey of private sector forecasters shows average forecast real GDP growth slowing only modestly to 3.5 per cent in 2000 and 2.9 per cent in 2001. This view likely reflects the expected cooling in U.S. economic growth over the same period, as well as the effects of somewhat tighter Canadian monetary conditions. The realization of such strong growth will mark the longest sustained economic expansion in two decades.

GDP inflation is now estimated to have averaged 1.6 per cent in 1999, up significantly from the decline in GDP prices of 0.6 per cent in 1998. Stronger GDP prices over the last year are due in part to the recovery in commodity prices. Private sector forecasters anticipate GDP inflation to edge up further to around 2 per cent during the next two years.

Overall, nominal GDP (which includes the impact of producer price inflation) is estimated to have grown 5.4 per cent in 1999. Private sector forecasters expect nominal GDP growth to average 5.7 per cent in 2000 and 4.9 per cent in 2001. This means that the total value of goods and services produced in Canada will exceed $1 trillion next year. The forecast level of nominal GDP for 2000 is now over $40 billion higher than predicted at the time of the 1999 budget and $13 billion higher than predicted in the 1999 fall update survey.

Table 2.3
Evolution of the Average Private Sector Forecast for Key Indicators

	1999	2000	2001
	(per cent, unless otherwise indicated)		
Real GDP growth			
January 1999 survey (1999 budget)	2.0	2.5	–
September 1999 survey (1999 fall update)	3.6	2.9	2.7
December 1999 survey (2000 budget)	**3.8**	**3.5**	**2.9**
GDP inflation			
January 1999 survey (1999 budget)	0.7	1.4	–
September 1999 survey (1999 fall update)	1.5	1.7	1.9
December 1999 survey (2000 budget)	**1.6**	**2.1**	**1.9**
Nominal GDP growth			
January 1999 survey (1999 budget)	2.7	3.9	–
September 1999 survey (1999 fall update)	5.1	4.6	4.6
December 1999 survey (2000 budget)	**5.4**	**5.7**	**4.9**
Nominal GDP level ($ billions)			
January 1999 survey (1999 budget)[1]	920	956	–
September 1999 survey (1999 fall update)	941	984	1,029
December 1999 survey (2000 budget)	**944**	**997**	**1,046**
Employment growth			
January 1999 survey (1999 budget)	1.9	1.6	–
September 1999 survey (1999 fall update)	2.5	1.7	1.7
December 1999 survey (2000 budget)	**2.7**	**2.2**	**1.7**
Unemployment rate			
January 1999 survey (1999 budget)	8.2	8.1	–
September 1999 survey (1999 fall update)	7.9	7.6	7.5
December 1999 survey (2000 budget)	**7.6**	**6.8**	**6.7**
CPI inflation			
January 1999 survey (1999 budget)	1.4	1.6	–
September 1999 survey (1999 fall update)	1.6	1.9	1.9
December 1999 survey (2000 budget)	**1.8**	**2.3**	**2.1**
3-month Treasury bill rate			
January 1999 survey (1999 budget)	4.4	4.5	–
September 1999 survey (1999 fall update)	4.8	5.1	5.1
December 1999 survey (2000 budget)	**4.7**	**5.2**	**5.3**
10-year government bond yield			
January 1999 survey (1999 budget)	5.1	5.4	–
September 1999 survey (1999 fall update)	5.6	5.8	5.8
December 1999 survey (2000 budget)	**5.5**	**6.2**	**6.0**

[1] Nominal GDP levels have been adjusted to reflect June 1999 revisions to Canada's National Income and Expenditure Accounts.

Private sector forecasters have also become more positive over the last year about job creation. Employment growth is expected to slow less than previously forecast this year, from 2.7 per cent in 1999 to 2.2 per cent in 2000 and 1.7 per cent in 2001, in tandem with the forecast easing in real GDP growth. Healthy labour market conditions are expected to induce a moderate improvement in labour force participation (the share of work-eligible Canadians holding or seeking jobs) over the same period. As a result, the unemployment rate is forecast to continue to average slightly below 7 per cent during the next two years, following significant declines in 1999.

Higher economic growth forecasts in both Canada and the U.S. have been accompanied by upward revisions to private sector interest rate forecasts. Canadian short-term interest rates are now expected to average 5.2 per cent in 2000 and 5.3 per cent in 2001, about 10 to 20 basis points higher than forecast in the 1999 fall update survey. These upward revisions are consistent with increases in interest rates that have occurred since then, as well as upward revisions to U.S. interest rate forecasts for 2000.

Long-term interest rates are expected to average 6.2 per cent in 2000 and to decline modestly to 6.0 per cent in 2001. This indicates that inflation pressures are widely expected to remain contained over the next two years, and reflects continued progress in reducing government debt-to-GDP ratios as well as the success of the inflation control targets.

Private sector forecasters project consumer price inflation to ease from current levels in 2000, moving closer to the midpoint of the target band (1 to 3 per cent) set jointly by the Government and the Bank of Canada. This is consistent with expectations that the temporary pass-through effect of the significant increase in energy prices last year will ease over the near term.

The OECD and IMF share this positive assessment of Canada's growth prospects. Indeed, Canada is expected to post the second fastest economic growth among the Group of Seven major industrial countries in 2000 and to lead in job creation. The OECD and IMF also forecast inflation to remain well within the inflation target band.

It should be noted that economic and financial market developments since the last complete survey of private sector forecasters in mid-December have led to some revisions to private sector views. Although a full round of updated forecasts will not be available until March, a number of private sector forecasters have revised upwards their expectations for interest rates and growth in both Canada and the U.S. In particular, results from a partial survey of private sector forecasters conducted in early February indicated expectations that Canadian short- and long-term interest rates would average around 25 basis points higher in 2000 and 2001 than in the December survey. Preliminary expectations for real GDP growth were also slightly higher (0.2 percentage points in 2000 and 0.1 percentage points in 2001).

From a fiscal perspective, such revisions would be roughly neutral as the positive implications of higher growth forecasts offset the negative effects of higher interest rate forecasts. Hence, the fiscal projections prepared on the basis of the December economic forecasts remain an appropriate basis for budget planning.

Risks to the Canadian Outlook and Economic Prudence

The main risks to the economic outlook stem from possible developments abroad, mainly in Canada's largest trading partner. The U.S. economy posted higher-than-expected income and productivity growth but lower-than-expected inflation in 1999. Temporarily depressed import and energy prices following the Asian crisis contributed to this impressive performance. However, a significant increase in productivity growth – rooted in technological advances in the production of computers and increased use of computers across industries – has also played a major role by expanding the non-inflationary growth capacity of the U.S. economy.

Despite this increased growth capacity, it is widely believed that domestic demand growth in the U.S. must moderate somewhat from current rates if inflation pressures are to be avoided. Forecasters are still generally of the view that further moderate increases in U.S. interest rates will be sufficient to achieve the needed moderate slowing in growth. However, the emergence of inflationary pressures is considered to be the most significant risk to the U.S. economic outlook. Concerns have also been raised

regarding other potential imbalances in the U.S. economy, such as the high current account deficit, which may complicate the conduct of monetary policy. These concerns suggest that more significant increases in U.S. interest rates than are currently anticipated may eventually be necessary to slow U.S. growth sufficiently to avoid inflation pressures. As witnessed by developments since the beginning of the year, higher-than-expected increases in U.S. rates could spill over to Canada in the form of higher Canadian interest rates.

Evidence that the non-inflationary capacity of the Canadian economy has also expanded in recent years counterbalances these risks to the outlook. While there is much uncertainty surrounding any estimate of the non-inflationary productive capacity of the Canadian economy, there are signs that Canada's capacity to sustain robust, non-inflationary growth has increased as a result of structural reforms, the restoration of sound public finances and technological developments. For example, increases in unit labour costs remained well below inflation in 1999 – and indeed decelerated over the first three quarters of the year – despite robust growth and substantial declines in the unemployment rate.

The risks to the economic outlook underscore the importance of maintaining the prudent planning approach of past budgets. This is why fiscal planning in every budget starts by establishing the amount of economic prudence required to cushion against potential pressures on government finances due to higher-than-expected interest rates or lower-than-forecast growth. This helps to ensure that the Government can continue to meet its commitment to balanced budgets or better. Since risks to the outlook appear to remain balanced, economic prudence has been set at normal levels of $1 billion in 2000-01 and $2 billion in 2001-02, as in the 1999 *Economic and Fiscal Update.*

3

Better finances, better lives

Maintaining Sound Financial Management

Highlights

- The fiscal outlook reflects the Government's plan to take Canada into the 21st century: maintaining sound financial management, lowering taxes, investing in providing Canadians with the skills and knowledge they need, and building an innovative economy.
- The Government is committing to balanced budgets or better in 1999-2000, 2000-01 and 2001-02. This would be only the third time since Confederation that the budget has been balanced or in surplus for at least five consecutive years and the first time in the last 50 years.
- The Government will continue to follow its prudent and transparent approach to budget planning. In accordance with the Debt Repayment Plan, it will continue to use the Contingency Reserve to reduce the public debt in those years when the reserve is not required.

Highlights *(cont'd)*

- Sustained economic growth and the Debt Repayment Plan will ensure that the debt-to-GDP ratio – the level of debt in relation to the country's annual income – remains on a permanent downward track. From a post-World War II peak of 71.2 per cent in 1995-96, it is expected to be about 61 per cent in 1999-2000, fall to about 55 per cent by 2001-02 and continue to fall to under 50 per cent by 2004-05.
- The tax relief measures proposed in this budget, together with those introduced in the 1998 and 1999 budgets, will result in a substantial lowering of the revenue-to-GDP ratio. This ratio is projected to decline to about 16 per cent in 2001-02 from 17.4 per cent in 1998-99. With the actions proposed in the Five-Year Tax Reduction Plan, it will continue to decline.
- The level of program spending in 2000-01 will be $4 billion lower than in 1993-94. From 1997-98, when the budget was first balanced, to 2001-02, growth in program spending will be held to roughly the growth in population and inflation. As a percentage of GDP, program spending is projected to decline from 12.4 per cent in 1997-98 to 11.6 per cent in 2001-02 – the lowest ratio in over 50 years. In 1993-94, it was 16.6 per cent.
- By accounting standards used in most other countries, the Government of Canada will post a financial surplus for the fourth consecutive year in 1999-2000 – the only Group of Seven (G-7) country to do so.
- The fiscal position of provincial-territorial governments is expected to improve for the seventh consecutive year in 1999-2000, resulting in their combined deficit falling to its lowest level in more than 20 years. Based on current budget plans, it should continue to decline.
- Canada recorded the largest improvement in its financial balance of all G-7 countries from 1992 to 1999.

Canada's Fiscal Progress in Perspective

The Government of Canada is now in a new fiscal era of budget surpluses that paves the way for further broad-based tax reductions and investments in key priorities. It is an era that hardly seemed possible in 1993-94 when the federal deficit reached $42 billion. High deficits and the resulting pressure on interest rates were pushing up the debt burden and depressing economic growth and job creation, which in turn further aggravated the debt burden. This crippling cycle was already hurting Canada's standard of living, and left unchecked, it would have resulted in far worse consequences for the country.

A New Era of Budget Surpluses

With the support of all Canadians, the $42-billion deficit was eliminated by implementing a program of spending restraint and practising sound and prudent economic management. In 1997-98, the Government was able to report a budgetary surplus of $3.5 billion, its first since 1969-70 (Chart 3.1). In addition to eliminating the deficit and posting a surplus, the Government was able that same year to begin making substantial investments in access to knowledge and skills through the Canadian Opportunities Strategy to support economic growth.

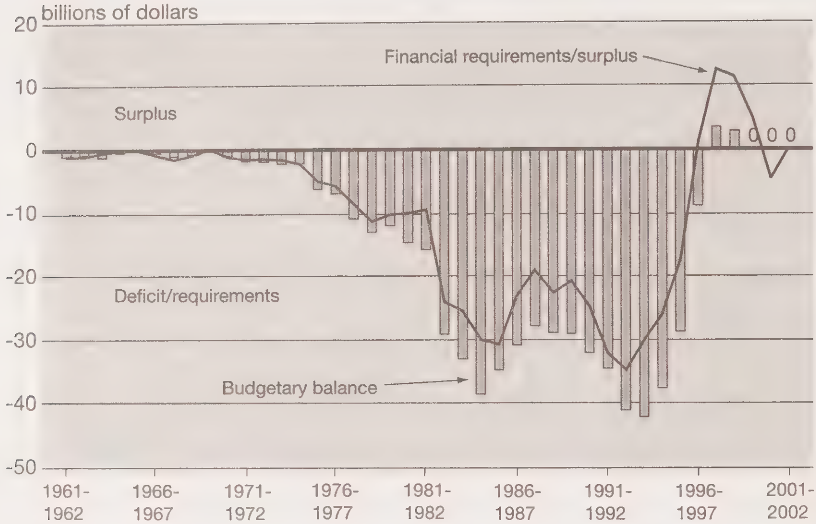
The following year, in 1998-99, the Government not only recorded a second consecutive budget surplus of $2.9 billion, but also invested substantially in health care, knowledge and skills, and tax relief.

Financial results for the first nine months of this fiscal year clearly indicate that a balanced budget, or better, will be recorded for 1999-2000. This will mark the third consecutive balanced budget or surplus – the first time this has occurred in nearly 50 years.

This underscores the soundness of the Government's fiscal strategy: using two-year rolling budget plans which are based on prudent planning assumptions backed by a Contingency Reserve, while adopting policies that support economic growth and job creation.

The Government is not prepared to risk a return to deficits. The benefits of maintaining sound public finances – sustained economic growth, more jobs and higher incomes for Canadians – will not be put at risk.

Chart 3.1
Federal Government Budgetary Balance and Financial Requirements/Surplus
(Public Accounts Basis)



This budget continues with that strategy. It proposes a five-year tax reduction plan and major new investments to make the Canadian economy more innovative and improve the quality of life of Canadians. Furthermore, after accounting for these measures, the Government is committing to balanced budgets or better for 2000-01 and 2001-02. This will mark five consecutive years of balanced budgets or surpluses. Since Confederation, there have been only two other occasions when the Government of Canada recorded balanced budgets or better for at least five consecutive years – in the 1920s, and again in the late 1940s through to the early 1950s, the period of demobilization following World War II.

The combined federal, provincial and territorial government sector also recorded a small surplus in 1998-99, as the federal surplus of $2.9 billion offset the consolidated provincial-territorial deficit of $1.9 billion. This was a remarkable turnaround from 1992-93, when the combined government-sector deficit was $66 billion. Based on current plans and the commitment of all provinces and territories to balanced budgets, the total provincial-territorial deficit should continue to decline. Further information on the combined federal-provincial-territorial government-sector balance is presented in Annex 3.

Financial Requirements/Surplus

The budgetary balance – deficit/surplus – is one measure of the Government's financial situation. It is presented largely on an accrual basis of accounting. Therefore, it includes liabilities incurred by the Government regardless of when the actual cash payment is made.

Another important measure of the Government's finances is the financial requirements/surplus – the difference between cash coming into the Government and cash payments made for programs and public debt charges during the year. Thus, unlike the budgetary balance, the financial requirements/surplus does not include any liabilities incurred by the Government for which no cash payment has been made during the year. The Government has recorded a financial surplus in each of the last three years – $1.3 billion in 1996-97, $12.7 billion in 1997-98 and $11.5 billion in 1998-99. Based on financial results to date this fiscal year, a financial surplus of $8 billion is expected in 1999-2000.

Financial requirements/surplus is broadly comparable to the measures of the budgetary balance used by most other major industrialized countries, including the United States. Among central federal governments within the Group of Seven industrialized countries (G-7), Canada was the first country to record a financial surplus this decade and only Canada, the United States and the United Kingdom are expected to continue to record financial surpluses over the near term.

Debt-to-GDP Ratio on Permanent Downward Track

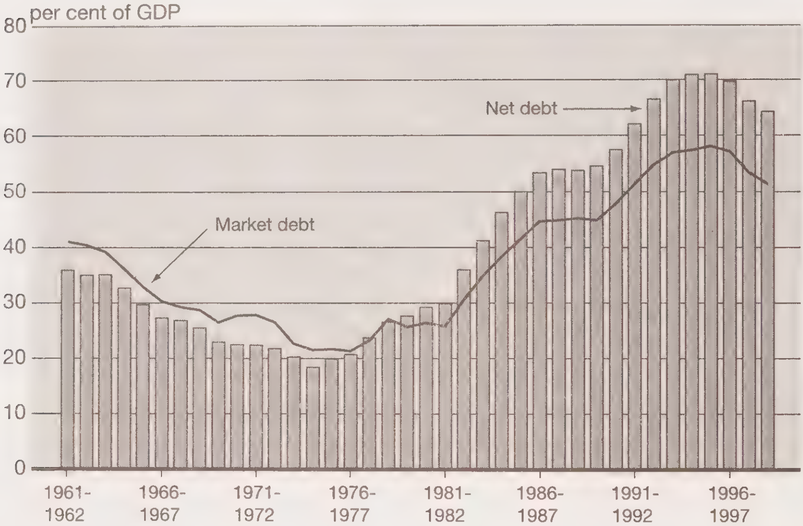
With budgetary surpluses in each of the last two fiscal years, the stock of public debt has declined by $6.4 billion. More importantly, the federal debt-to-GDP ratio has declined each year since 1995-96. This ratio is generally recognized as the most appropriate measure of the debt burden, as it measures debt relative to the ability of the Government and the country's taxpayers to finance it. In 1995-96, it reached a post-war peak of 71.2 per cent. By 1998-99, it had dropped to 64.4 per cent. With sustained economic growth and the Debt Repayment Plan, the debt-to-GDP ratio will continue to decline.

Although the deficit has been eliminated, the debt-to-GDP ratio is still too high, both by historical experience (Chart 3.2) and by international standards (Annex 4). Further reduction of the debt-to-GDP ratio remains a key objective of the Government's fiscal policy.

Chart 3.2

Federal Debt-to-GDP Ratio

(Public Accounts Basis)



Financial requirements/surplus provides a broad indication of the change in market debt actually outstanding and held by investors in the form of Government of Canada bonds, Canada Savings Bonds and Treasury bills. The Government retired a total of $16.4 billion of market debt in 1997-98 and 1998-99. Based on results to date, additional debt retirement will occur in 1999-2000, which could bring the total retirement to about $20 billion. This will provide ongoing interest savings. As a percentage of GDP, market debt has declined from a post-war peak of 58.2 per cent in 1995-96 to an estimated 48.5 per cent in 1999-2000.

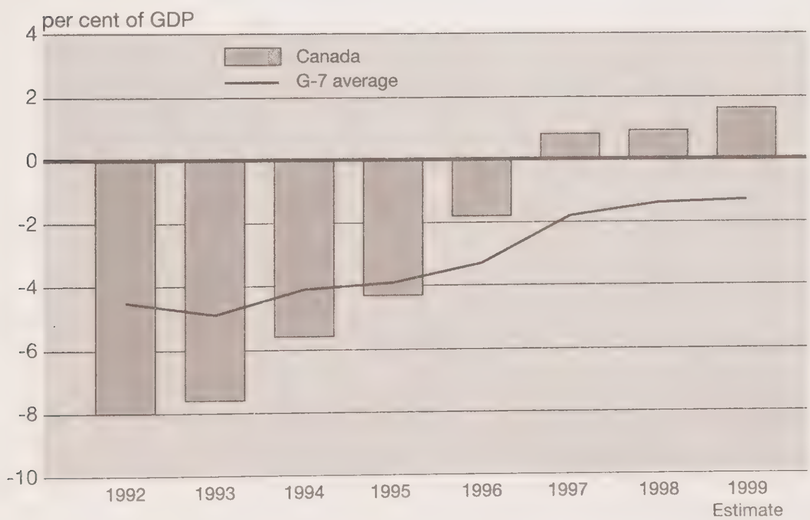
Canada's Fiscal Progress Best Among G-7 Countries

When making comparisons with other countries, adjustments must be made for differences in both the accounting practices and distribution of responsibilities among the various levels of government in each country. For international comparisons, the most appropriate measure is the total government-sector budget balance on a National Accounts basis. For Canada, the total government sector includes federal, provincial, territorial and local governments as well as the Canada Pension Plan and Quebec Pension Plan.

Canada's budgetary position has gone from being among the worst in the G-7 in the early 1990s to the best today. In 1992, Canada's total government-sector deficit reached a high of 8 per cent of GDP, compared to the G-7 average of 4.5 per cent (Chart 3.3).

Chart 3.3

Total Government-Sector Deficit (-)/Surplus (+)
(National Accounts Basis)



Source: *OECD Economic Outlook*, December 1999.

Subsequent deficit reduction efforts by all levels of Canadian government resulted in a total government budget surplus in 1997 – Canada was the first G-7 country to record a surplus in the 1990s. The Organisation for Economic Co-operation and Development (OECD) estimates that Canada's budget surplus reached 1.6 per cent of GDP in 1999, compared to an average deficit of 1.3 per cent among G-7 countries (detailed international comparisons are provided in Annex 4).

Fiscal Outlook: The Two-Year Planning Horizon to 2001-02

Introduction and Overview

During the spring and fall of 1999, the Department of Finance Canada engaged in an unprecedented consultation process with the chief economists of Canada's major chartered banks and four leading economic forecasting firms. The private sector economists recommended that the prudent approach to budget planning contained in the Government's Debt Repayment Plan be continued. This entails:

- continuing to use the average of private sector economic forecasts for budget planning purposes;
- continuing the practice of setting aside an annual $3-billion Contingency Reserve, which is used primarily to cover risks arising from unavoidable inaccuracies in the models used to translate economic assumptions into detailed fiscal forecasts and unpredictable events. It also provides an extra measure of backup against adverse errors in the economic forecasts. It is not a source of funding for new policy initiatives. If not needed, it will be used to pay down the public debt; and
- continuing to add an extra degree of economic prudence to provide further assurance against falling back into a deficit.

In past budgets, this prudence was included in revenue and expenditure projections. As a result, its fiscal impact was not explicitly identified, which made it difficult to judge the credibility of the key components of the fiscal projections. This extra prudence is now clearly and explicitly shown. In the years when this extra prudence is not required, it will become part of future planning surpluses.

The Economic and Fiscal Update, presented on November 2, 1999, contained five-year fiscal projections based on the above approach. It was the view of the private sector economists that, for the purposes of public debate on policy options, a five-year time horizon was appropriate. However, the economists agreed that great caution is warranted in the use of long-term projections for budget decisions.

As a result, budget decisions will continue to be made within a rolling two-year planning horizon, reflecting the difficulties in forecasting economic events over a longer time period. As such, spending initiatives and tax cuts will be introduced only when the Government is reasonably certain that it has the necessary resources to do so. This protects against the risk of having to make hasty, and potentially damaging, corrections to the budget plan.

The fiscal projections to 2001-02 are presented in Table 3.1. The Government is committing to balanced budgets or better in 1999-2000, 2000-01 and 2001-02. These targets are based on the average of private sector economic forecasts, include a Contingency Reserve of $3 billion each year as well as economic prudence – $1.0 billion in 2000-01 and $2 billion in 2001-02 – and include all the proposed budget actions.

On the basis of balanced budgets in 1999-2000 and in each of the next two years, the absolute stock of public debt remains unchanged at its 1998-99 level. However, as was the case in each of the past two years, to the extent that the Contingency Reserve is not needed, it will be used to pay down the public debt. As a percentage of GDP, net public debt is projected to fall to about 55 per cent in 2001-02, down 16 percentage points from the post-war peak of 71.2 per cent in 1995-96 (Chart 3.4). Assuming nominal GDP growth averages 3.5 per cent annually and an annual balanced budget, the debt-to-GDP ratio would fall to below 50 per cent in 2004-05.

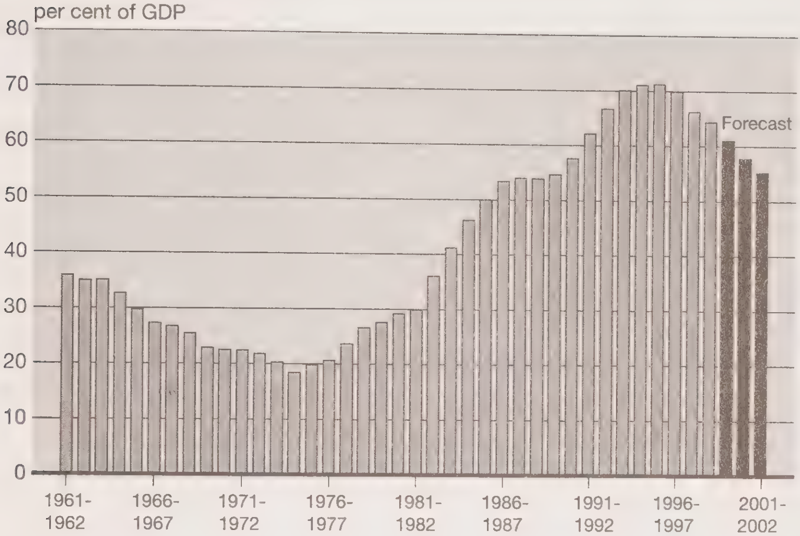
A financial surplus of $8 billion is expected in 1999-2000, marking the fourth consecutive year that the Government has taken in more cash than is needed to pay for current operations and interest on the public debt. However, the impact of public sector pension reform and payments related to the pay equity settlement and the Canada Health and Social Transfer (CHST) supplement are expected to result in a financial requirement of $5.0 billion in 2000-01. With the ending of these special payments, a financial balance is projected for 2001-02. The ongoing impact of public sector pension reform has resulted in a permanent lowering of the net cash available to the Government to finance its current operations from what it was in the past.

Table 3.1
Summary Statement of Transactions: The Two-Year Planning Horizon

	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002
	(billions of dollars)				
Budgetary transactions					
Budgetary revenues	153.2	155.7	160.0	162.0	168.0
Program spending	108.8	111.4	115.5	116.0	121.5
Operating balance	44.4	44.3	44.5	46.0	46.5
Public debt charges	40.9	41.4	41.5	42.0	41.5
Underlying budgetary balance	3.5	2.9	3.0	4.0	5.0
Prudence					
Economic prudence				1.0	2.0
Contingency Reserve			3.0	3.0	3.0
Total			3.0	4.0	5.0
Budgetary balance	**3.5**	**2.9**	**0.0**	**0.0**	**0.0**
Net public debt	579.7	576.8	576.8	576.8	576.8
Non-budgetary transactions	9.3	8.6	8.0	-5.0	0.0
Financial requirements/ surplus	12.7	11.5	8.0	-5.0	0.0
Percentage of GDP					
Budgetary revenues	17.5	17.4	16.9	16.2	16.1
Program spending	12.4	12.4	12.2	11.6	11.6
Public debt charges	4.7	4.6	4.4	4.2	4.0
Total expenditures	17.1	17.1	16.6	15.8	15.6
Budgetary balance	0.4	0.3	0.0	0.0	0.0
Net public debt	66.3	64.4	61.1	57.8	55.2
Financial requirements/ surplus	1.5	1.3	0.8	-0.5	0.0

Note: Numbers may not add due to rounding.

Chart 3.4
Federal Debt-to-GDP Ratio
(Public Accounts Basis)



Outlook for 1999-2000

The 1999 budget projected balanced budgets – or better – for 1998-99, 1999-2000 and 2000-01 and included an annual $3-billion Contingency Reserve in each year.

For 1998-99, a budgetary surplus of $2.9 billion was recorded. Budgetary revenues were $0.8 billion lower than estimated in the 1999 budget, primarily because of transfers to the Tax Collection Agreement Accounts (an "off-budget" account), reflecting underpayments with respect to the 1997 and 1998 taxation years. In contrast, program spending was $0.7 billion lower than expected, primarily reflecting lower direct program spending.

As a result, there was a drawdown of the Contingency Reserve of $0.1 billion, resulting in an audited surplus for the year of $2.9 billion.

The economy grew much faster in 1999 than forecast by the private sector economists at the time of the February 1999 budget. Nominal income growth for the year is now estimated at 5.4 per cent, double that anticipated in February 1999. The impact of this stronger-than-expected growth is reflected in the financial results for the first nine months of 1999-2000.

The budgetary surplus to the end of December 1999 is estimated at $10.9 billion (see *The Fiscal Monitor* for December 1999). However, with developments over the balance of the fiscal year, including the impact of the initiatives proposed in this budget, a balanced budget or better is forecast for the year as a whole. To the extent that the Contingency Reserve is not needed, it will be used to pay down the public debt.

During the balance of the fiscal year, including the end-of-year accounting period, but before the actions in this budget, a deficit of $3.4 billion is expected. This is due to the effect of higher Equalization transfers, the normal revenue profile during the final quarter of the fiscal year, the impact of spending initiatives announced before the 2000 budget (but not reflected in the results to December), the reduction in employment insurance (EI) premium rates effective January 1, 2000, and the income tax reductions announced in the February 1999 budget (Table 3.2). Revenues are typically depressed in January due to payment of the quarterly goods and services tax (GST) credit and again in March due to personal income tax refunds pertaining to the processing of tax returns. These factors should reduce the surplus before the Contigency Reserve from $10.9 billion to $7.5 billion.

Table 3.2
Fiscal Outlook for 1999-2000

	(billions of dollars)
Budgetary surplus to December 1999	10.9
Developments over balance of fiscal year	
Equalization transfers	-0.3
Revenue profile	-1.7
Spending initiatives announced before 2000 budget	-0.7
EI premium rate cut effective January 1, 2000	-0.3
Tax reductions announced in 1999 budget	-0.4
Total	-3.4
Planning surplus before Contingency Reserve	7.5
Planning surplus after Contingency Reserve	4.5
Less impact of 2000 budget policy actions	
CHST cash supplement	2.5
Making Canada's economy more innovative	1.3
Defence	0.4
Heavily Indebted Poor Countries initiative	0.2
Other operating and capital	0.1
Total	4.5
Expected outcome	0.0

Note: Numbers may not add due to rounding.

The Contingency Reserve is maintained at $3 billion in order to ensure that the budgetary target for 1999-2000 of a balanced budget or better will be realized. To the extent that the Contingency Reserve is not needed, it will be used to pay down the public debt. This leaves a planning surplus after the Contingency Reserve of $4.5 billion.

This remaining surplus has been allocated to priorities such as health care, higher education, access to knowledge and skills and innovation. This includes the $2.5-billion CHST cash supplement and another $1.3 billion for initiatives to make the economy more innovative, such as the $0.9-billion transfer to the Canada Foundation for Innovation.

Final audited financial results will be published in the *Annual Financial Report of the Government of Canada*, which is released in the fall of each year.

Changes Since the 1999 Budget Forecast

The changes in the major fiscal estimates since the 1999 budget are shown in Table 3.3. Because of stronger-than-expected economic growth, revenues for 1999-2000 are now significantly higher than anticipated at the time of the 1999 budget, and this is expected to carry forward into 2000-01. In addition, economic growth is also expected to be much stronger in 2000 than forecast at the time of the February 1999 budget, thereby leading to even higher revenues.

A strong economy and falling unemployment rates have resulted in lower-than-expected EI benefit payments. This has more than offset increases in transfers to other levels of government. The latter reflects a change in the planning assumption, as outlined in *The Economic and Fiscal Update*. In the past few years, Equalization entitlements have been subject to significant upward adjustments. To minimize the impact of such changes on the planning surplus, these entitlements are assumed to be at their legislated ceiling in 1999-2000 and to grow in line with the growth in nominal income thereafter. The increase in direct program spending in 2000-01 is attributable to the reprofiling of funds to that year, as well as to higher expenditures under the Canada Education Savings Grant program. The reprofiling of funds is subject to Treasury Board approval and promotes more efficient cash management practices.

The lower public debt charges reflect two factors. As explained in *The Economic and Fiscal Update,* unlike in previous budgets, the interest rate assumptions no longer include an adjustment for prudence. Interest rates in 1999 were somewhat lower than those used in the February 1999 budget. In addition, on the recommendation of the private sector economists, it is now assumed that the Contingency Reserve will not be needed in calculating public debt charges. Therefore, the stock of debt used to calculate public debt charges is lower than assumed in the 1999 budget.

The net impact of the economic developments and technical factors has been to increase the budgetary balance by $6.2 billion in 1999-2000 and $8.7 billion in 2000-01.

Initiatives announced since the 1999 budget, including those in this budget, total $6.2 billion for 1999-2000 (Annex 1), of which about $0.6 billion (primarily reflecting incremental funding related to the conflict in Eastern Europe) has been reflected in the monthly results to the end of December 1999. The rest – $5.6 billion – includes the proposed CHST cash supplement of $2.5 billion, funding to support the Canada Foundation for Innovation and incremental funding for defence and to meet other international commitments and obligations. For 2000-01, the fiscal cost of the policy initiatives amounts to $7.7 billion, the majority of which – $4.6 billion – is for general tax relief.

This results in an underlying surplus of $3.0 billion for 1999-2000 and $4.0 billion for 2000-01. From these amounts, prudence – the Contingency Reserve of $3 billion and economic prudence – must be subtracted. As indicated earlier, economic prudence is now shown separately, whereas in previous budgets it was incorporated in the projections of revenues, program spending and public debt charges. The economic prudence for 2000-01 has been set at $1.0 billion. For planning purposes, therefore, the Government is committing to balanced budgets in both 1999-2000 and 2000-01. To the extent the Contingency Reserve is not needed, it will be applied to reducing the public debt.

Table 3.3
The Fiscal Outlook: Changes Since the 1999 Budget

	1998-1999	1999-2000	2000-2001
		(billions of dollars)	
1999 budget underlying surplus (before Contingency Reserve)	3.0	3.0	3.0
Impact of economic developments			
Budgetary revenues			
Personal income tax	-1.2	1.6	2.7
Corporate income tax	-0.4	1.7	2.7
Other income tax	0.0	0.4	0.6
Employment insurance (EI) premiums	0.2	0.7	1.1
Goods and services tax	0.1	0.5	0.8
Other excise taxes and duties	0.0	-0.8	-0.4
Non-tax revenues	0.5	-0.3	-0.5
Total revenues	-0.8	3.6	7.0
Program spending			
Elderly benefits	0.0	-0.2	0.1
EI benefits	-0.2	-1.7	-2.0
Transfers to other levels of government	0.1	0.6	0.9
Direct program spending	-0.6	-0.3	0.7
Total	-0.7	-1.6	-0.3
Public debt charges	0.0	-1.0	-1.4
Net impact of economic developments	**-0.1**	**6.2**	**8.7**
Less: net impact of policy changes			
Affecting revenues		0.3	4.6
Affecting program spending		5.9	3.1
Net impact		6.2	7.7
Net change since 1999 budget	**-0.1**	**0.0**	**1.0**
2000 budget underlying surplus	2.9	3.0	4.0
Less: prudence			
Contingency Reserve		3.0	3.0
Economic prudence			1.0
Net impact		3.0	4.0
2000 budget budgetary planning balance		**0.0**	**0.0**

Note: Numbers may not add due to rounding.

Changes Since *The Economic and Fiscal Update*

In *The Economic and Fiscal Update*, the fiscal surplus for planning purposes – that is, after allowance for economic prudence and the Contingency Reserve – was projected at $2.0 billion in 1999-2000, $5.5 billion in 2000-01 and $8.5 billion in 2001-02.

For 1999-2000, the planning surplus has been revised up by $3.5 billion, to $5.5 billion. Of this increase, about half is attributable to one-time factors – transfers from the Tax Collection Agreement Accounts relating to overpayments with respect to the 1998 taxation year, and reprofiling of funds from 1999-2000 to future years. The remainder reflects the impact of stronger-than-expected economic growth, resulting in higher revenues and lower EI benefits.

For 2000-01, the planning surplus has been revised up by $0.8 billion, to $6.2 billion. This reflects the impact of stronger-than-expected economic growth on revenues and EI benefits, dampened by the reprofiling of funds from 1999-2000 and higher public debt charges reflecting somewhat higher interest rates than those assumed in *The Economic and Fiscal Update*. For 2001-02, the planning surplus has been revised up by $2.3 billion, to $10.9 billion, reflecting the impact of stronger-than-expected economic growth, partially offset by somewhat higher public debt charges.

The net impact of the policy initiatives since the 1999 budget amounts to $6.2 billion in 1999-2000, $7.7 billion in 2000-01 and $12.0 billion in 2001-02. However, *The Economic and Fiscal Update* planning surplus projections already incorporated the decline in EI premium rates from $2.55 (employee rate per $100 of insurable earnings) in 1999 to $2.40 in 2000 and assumed that they would be held at that level for 2001 and 2002. In addition, the projections included expenditures committed at that time ($0.5 billion in 1999-2000 and $0.3 billion in 2000-01) associated with Canada's international peacekeeping activities. The net impact of these adjustments was $0.8 billion in 1999-2000, $1.4 billion in 2000-01 and $1.0 billion in 2001-02. As a result, the net impact of the policy decisions since *The Economic and Fiscal Update* is $5.5 billion in 1999-2000, $6.2 billion in 2000-01 and $10.9 billion in 2001-02.

Table 3.4
The Fiscal Outlook: Changes Since The Economic and Fiscal Update

	1999-2000	2000-2001	2001-2002
	(billions of dollars)		
The Economic and Fiscal Update			
Fiscal surplus for planning purposes	2.0	5.5	8.5
Impact of economic developments			
Budgetary revenues			
Personal income tax	1.7	0.8	1.5
Other	0.3	0.1	0.9
Program spending			
Major transfers to persons	-0.7	-0.1	-0.8
Major transfers to other levels of government	-0.1	0.1	0.2
Direct program spending	-0.6	0.6	0.3
Public debt charges	0.0	0.4	0.5
Net impact	3.5	0.8	2.3
Revised surplus for planning	5.5	6.2	10.9
Net impact of policy initiatives			
Total impact of initiatives since 1999 budget	6.2	7.7	12.0
Less policy initiatives included in fiscal update planning surplus	0.8	1.4	1.0
Net impact of policy initiatives since *The Economic and Fiscal Update*	5.5	6.2	10.9
2000 budget budgetary planning balance	0.0	0.0	0.0

Note: Numbers may not add due to rounding.

Outlook for Budgetary Revenues: The Two-Year Planning Horizon

The revenue outlook to 2001-02 is summarized in Table 3.5.

Through the first nine months of 1999-2000, budgetary revenues were up 3.2 per cent over the same period in 1998-99. During the balance of the year, revenue growth is expected to slow somewhat relative to the same period last year. This primarily reflects the reduction in EI premium rates, the ongoing impact of the tax relief measures announced in the 1998 and 1999 budgets and a slowdown in GST revenues, attributable to higher refunds and rebates. For the year as a whole, budgetary revenues are expected to be up 2.8 per cent from 1998-99.

Table 3.5
The Revenue Outlook

	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002
	(billions of dollars)				
Income tax revenues					
Personal income tax	70.8	72.5	76.5	75.9	78.7
Corporate income tax	22.5	21.6	22.5	23.9	24.8
Other income tax	3.0	2.9	3.3	3.5	3.6
Total income tax	96.3	97.0	102.3	103.2	107.1
Employment insurance premiums	18.8	19.4	18.6	18.2	18.0
Excise taxes and duties					
Goods and services tax	19.5	20.7	22.1	23.1	24.5
Customs import duties	2.8	2.4	2.2	2.3	2.3
Other excise taxes/duties	8.6	8.4	7.8	8.2	8.6
Total	30.9	31.4	32.0	33.5	35.4
Total tax revenues	**145.9**	**147.7**	**152.8**	**154.9**	**160.7**
Non-tax revenues	7.2	7.9	7.2	7.2	7.4
Total budgetary revenues	**153.2**	**155.7**	**160.0**	**162.0**	**168.0**
Percentage of GDP					
Total budgetary revenues	17.5	17.4	16.9	16.2	16.1
Total excluding impact of 1998, 1999 and 2000 budget measures	17.5	17.6	17.5	17.6	17.6

Note: Numbers may not add due to rounding.

For 2000-01, growth in total budgetary revenues is expected to slow to 1.3 per cent, reflecting the impact of the tax relief measures from the 1998, 1999 and 2000 budgets. For 2001-02, budgetary revenues are expected to rebound somewhat but still grow more slowly than the growth in the applicable tax bases, reflecting the incremental impact of the tax relief measures.

Personal income tax collections, the largest single source of federal revenues, are expected to increase 5.5 per cent in 1999-2000, following an increase of only 2.4 per cent in 1998-99. Revenues in 1998-99 were depressed due to transfers to the Tax Collection Agreement Accounts, reflecting underpayments related to previous taxation years, and due to the impact of the tax relief measures announced in the 1998 budget.

In 2000-01, personal income tax revenues are projected to decline, reflecting the impact of the tax relief measures proposed in this budget, as well as the incremental impacts of the tax relief measures announced in the 1998 and 1999 budgets. In 2001-02, personal income tax collections are expected to grow 3.8 per cent, as the ongoing impacts of the tax relief measures proposed in this budget dampen the impact of the growth in the applicable tax base.

During the first nine months of 1999-2000, corporate income tax collections were up 2.0 per cent. They are expected to average about 10 per cent more than 1998-99 levels for the remainder of the year. Under remittance regulations, corporations make monthly instalments based on the lesser of their current year's or previous year's tax obligation. Final settlement payments for a taxation year are normally made two months after the end of the taxation year – with the majority being made in February and March. Corporate profits rebounded strongly in 1999, following a decline in 1998. Consequently, settlement payments in the February and March 2000 period are expected to be significantly greater than the payments made in the 1999 settlement period.

For 2000-01, growth in corporate income tax collections is expected to further increase to 6.0 per cent, reflecting continued gains in profitability. A moderation in growth is expected in 2001-02, in part due to the reduction in the general tax rate.

EI premium revenues are expected to decline 4.2 per cent in 1999-2000 as the reduction in premium rates for 1999 and 2000 more than offsets the effects of increased employment and wages.

The premium rate for 1999 was $2.55 (employee rate per $100 of insurable earnings), down from $2.70 in 1998. For 2000, the employee rate has been set at $2.40. Prior-year adjustments in 1998-99, relating to underpayments for the 1997 taxation year, also contributed to the decrease.

For planning purposes, the Government is assuming a 10-cent per year decline in EI premium rates, moving towards the point where premiums would cover only ongoing program costs. Premium rates are set each year in the fall. The Government is closely examining the recommendations of the House of Commons Standing Committee on Finance on future premium rate setting. For 2000-01, EI premium revenues are projected to continue to decline, as the assumed reduction in premium rates is expected to more than offset the gains from higher employment.

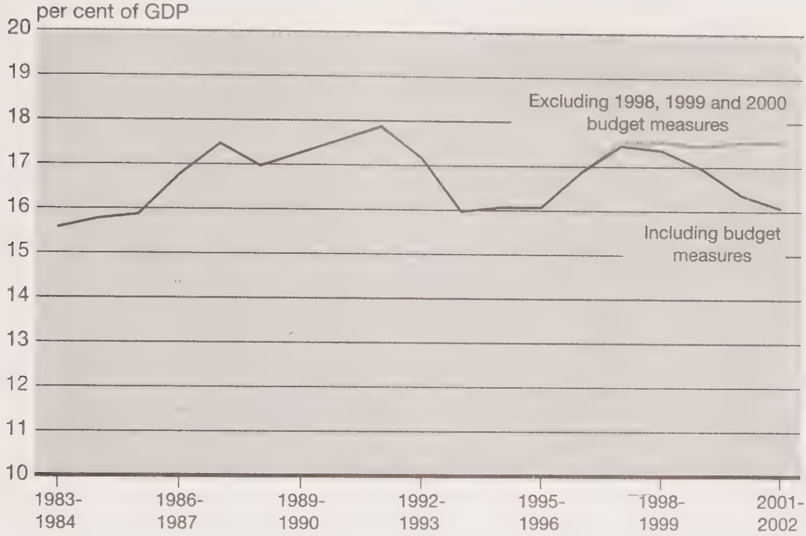
GST revenues are expected to increase 6.6 per cent in 1999-2000, somewhat faster than the growth in consumption of goods and services subject to the tax. Continued robust growth in consumer spending will sustain the growth of GST receipts in both 2000-01 and 2001-02. Other excise tax collections are expected to decline in 1999-2000, largely due to the elimination of the Air Transportation Tax.

Non-tax revenues include returns on investments, most notably Bank of Canada profits and Exchange Fund earnings, and other non-tax revenues. Non-tax revenue is expected to decline in 1999-2000 because of recoveries related to previous years' expenditures that increased revenues in 1998-99. Thereafter, they are projected to be relatively stable.

Measures proposed in this budget and announced in the previous two budgets will significantly lower the ratio of budgetary revenues to GDP over the two-year outlook horizon. In the absence of these measures, the ratio would have remained relatively stable at around 17.6 per cent (Chart 3.5). With these measures, it is expected to decline from 17.4 per cent in 1998-99 to 16.1 per cent in 2001-02. Including the measures proposed in the Five-Year Tax Reduction Plan, the revenue ratio should continue to fall.

Chart 3.5

Revenue-to-GDP Ratio
(Public Accounts Basis)



Outlook for Program Spending: The Two-Year Planning Horizon

Table 3.6 presents the major components of program spending – total budgetary expenditures excluding interest on the public debt – through to 2001-02. The profile of program spending reflects the impact of the initiatives announced since the 1999 budget, including those in this budget.

In 1993-94, program spending amounted to $120.0 billion. Reflecting the impact of the restraint measures implemented in the 1994, 1995 and 1996 budgets, program spending fell to $104.8 billion in 1996-97 – the year before the federal government recorded its first budgetary surplus in nearly 30 years. The restraint measures included:

- elimination of a number of business subsidies, especially in the areas of energy and transportation;
- significant cuts to defence and international assistance;
- reductions in departmental operating and capital spending resulting in cuts to the size of the federal public service – 60,000 jobs were eliminated over four years – and freezes in wages and salaries;

- reforms to the EI program; and
- restructuring of transfers to other levels of government through the introduction of the CHST.

With the era of deficit financing over, the 1997, 1998 and 1999 budgets began to make strategic investments in key priorities for Canadians – health care, innovation and access to knowledge and skills – in addition to providing tax relief. The 1997 budget provided initial funding of $800 million to the Canada Foundation for Innovation. In the 1998 budget, the CHST cash floor of $11 billion, which was established in 1996, was raised to $12.5 billion effective 1997-98. The 1999 budget committed an additional $11.5 billion to the CHST over five years for health care. The 1998 budget provided $1.5 billion per year to the Canadian Opportunities Strategy to support the acquisition of knowledge and skills through measures such as the creation of the Canada Millennium Scholarship Foundation and the Canada Education Savings Grant. Building on that strategy, the 1999 budget provided additional support for the creation, dissemination and commercialization of knowledge and innovation, bringing total investment in support of skills and access to knowledge to about $1.8 billion in the current fiscal year, rising to $2 billion next year.

In this budget, the Government is providing incremental funding, on a carefully targeted basis, to a number of departments facing immediate pressures to ensure that core public service functions are maintained. This includes an enhancement of existing farm income disaster assistance to help manage the farm crisis, incremental funding to help National Defence meet its obligations, and funding to the Royal Canadian Mounted Police to combat organized crime and meet its undertakings with provinces. As noted in Chapter 5, the Government's own infrastructure requires improvement to address health and safety concerns and to maintain services. In addition, federal departments, like the private sector, need to be able to take full advantage of the new technologies so that they can serve Canadians in the most efficient and cost-effective manner possible.

Including the initiatives announced in this budget and the previous two budgets, program spending is expected to amount to $116 billion in 2000-01, $4 billion lower than the level of

spending in 1993-94. Over this time period, consumer prices are expected to increase by about 11 per cent and population by 7.4 per cent, for a projected cumulative increase of about 19 per cent. This implies that program spending would decline over 20 per cent in real per capita terms.

Over the planning horizon, program spending is expected to increase to $121.5 billion in 2001-02, an increase of $1.5 billion from the level reported in 1993-94. Since 1997-98, this represents an annual average increase of 2.8 per cent. This is in line with the expected average inflation and population growth of 2.7 per cent over this period. As a share of GDP, program spending is projected to continue to decline over the planning horizon – from 12.4 per cent in 1997-98 to 11.6 per cent in 2001-02 – the lowest ratio in over 50 years.

Program spending falls into three components, which are reviewed in the following sections: major transfers to persons, major transfers to other levels of government and direct program spending.

Major Transfers to Persons

Major transfers to persons consist of elderly benefits – Old Age Security, the Guaranteed Income Supplement and the Spouse's Allowance – and EI benefits.

Elderly benefits are expected to continue to rise steadily over the outlook period, reflecting the growth in both the senior population and average benefits, which are fully indexed to consumer prices.

EI benefits are estimated at $11.7 billion for 1999-2000, down slightly from 1998-99, as a decrease in the number of people unemployed offsets increases in the weekly benefit rate and in payments under the Labour Market Development Agreements with most provinces and territories. A slight increase is expected in 2000-01, as increases in the average benefit rate and in transfers under the Labour Market Development Agreements offset the impact of the further projected decline in the unemployment rate. The fiscal impact of the proposed extension of parental benefits amounts to $0.6 billion in 2001-02 and accounts for most of the increase in benefits in that year.

Table 3.6
The Outlook for Program Spending

	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002
	(billions of dollars)				
Major transfers to persons					
Elderly benefits	22.2	22.8	23.3	24.2	25.0
Employment insurance benefits	11.8	11.9	11.7	11.8	12.8
Total	34.1	34.7	35.0	36.0	37.8
Major transfers to other levels of government					
CHST[1]	12.4	12.5	12.5	13.5	14.5
CHST cash supplement[2]		3.5	2.5		
Fiscal transfers	10.2	11.6	11.0	11.5	12.1
Alternative payments for standing programs	-2.1	-2.1	-2.4	-2.4	-2.5
Total	20.5	25.5	23.6	22.6	24.1
Direct program spending					
Subsidies and other transfers					
Agriculture	0.8	0.8	1.7	1.3	1.2
International Assistance Envelope	1.9	2.1	2.2	2.1	2.2
Health	0.9	1.2	1.1	1.2	1.3
Human Resources Development	2.1	2.4	2.3	2.8	3.0
Indian Affairs and Northern Development	4.3	4.1	4.1	4.3	4.3
Industry and regional agencies	2.2	2.3	3.2	2.3	2.4
Veterans Affairs	1.4	1.4	1.4	1.4	1.4
Other	8.9	4.5	4.2	4.3	4.4
Total	22.5	18.7	20.2	19.6	20.2
Crown corporations	2.5	3.5	3.8	4.1	4.0
Departmental operating and capital					
Defence	8.9	8.8	9.9	9.4	9.5
All other	20.3	20.2	23.0	24.3	26.0
Total direct program spending	**54.2**	**51.2**	**56.9**	**57.4**	**59.7**
Total program spending	**108.8**	**111.4**	**115.5**	**116.0**	**121.5**

[1] Reflects profile of CHST cash as accounted for by the federal government (Chapter 6).

[2] CHST cash supplement in 1999-2000 will be paid to a third-party trust in 2000-01, on passage of authorizing legislation.

Note: Numbers may not add due to rounding.

Major Transfers to Other Levels of Government

Every year the Government of Canada transfers significant funds to the provinces and territories under the CHST and fiscal transfers. The latter include Equalization, Territorial Formula Financing, statutory subsidies and recoveries under the Youth Allowance Program. The 1999 budget put the major transfers on common five-year funding tracks, thereby providing the provinces and territories with improved predictability in funding.

The CHST is a block-funded transfer that supports health care, post-secondary education, and social assistance and social services. It is delivered in the form of cash and tax transfers. The tax transfer component reflects a transfer of personal and corporate income tax room made to the provinces in 1977.

In the 1999 budget, the Government announced the single largest investment it has ever made – an $11.5-billion increase in funding, specifically for health care, over five years. CHST cash payments were increased by $1 billion in 2000-01, $2 billion in 2001-02 and $2.5 billion in 2002-03 and 2003-04, for a total of $8 billion.

In addition, the Government provided a CHST cash supplement of $3.5 billion, which was accounted for in 1998-99. This supplement was paid into a third-party trust so that individual provinces and territories could draw down the supplement (over three years starting in 1999-2000) in a pattern which best meets the needs of their health care systems.

This budget proposes to provide the provinces and territories with another cash supplement of $2.5 billion to support post-secondary education and health care. This amount will be accounted for in 1999-2000. It will also be paid into a third-party trust on passage of proposed amendments to the relevant legislation. It is anticipated that the provinces and territories will draw down this supplement in a gradual manner such that the total cash support will increase by $1.0 billion in 2000-01 and $0.5 billion per year in each of the following three years. However, flexibility will be provided so that the provinces and territories can draw down their allocations in a manner that best serves their needs.

The largest component under fiscal transfers is Equalization. This program provides less prosperous provinces with federal money to assist them in offering programs and services to their residents. It allows provinces with below-average capacities to

raise revenues to provide public services that are reasonably comparable to those found elsewhere in the country without imposing above-average tax rates. Currently, seven provinces receive these payments: Newfoundland, New Brunswick, Prince Edward Island, Nova Scotia, Quebec, Manitoba and Saskatchewan.

Payments under the Equalization program are made on the basis of a formula set out in legislation. The legislation also stipulates that the growth in entitlements cannot exceed the growth in GDP. However, there are often large adjustments in current years pertaining to revisions to economic data, which in turn affect entitlements for prior years. For example, data revisions relating to 1996 and 1997, primarily resulting from stronger growth than anticipated in Ontario relative to the Equalization-receiving provinces, resulted in large payments in 1998-99 relating to previous years. This one-time adjustment in 1998-99 accounts for the decline in cash payments between 1998-99 and 1999-2000. For planning purposes, the outlook assumes that, beginning in 2000-01, growth in Equalization payments will equal growth in nominal GDP.

Also included under fiscal transfers is Territorial Formula Financing, which is a transfer to the territorial governments of the Yukon, Northwest Territories and Nunavut, and which recognizes the unique challenges and higher costs of providing public services in the north.

Finally, alternative payments for standing programs represent recoveries of federal tax point abatements under contracting-out arrangements. Provinces were given the option in the mid-1960s to accept tax points in lieu of cash transfers. The value of these tax points is netted against total entitlements, and the difference is subtracted accordingly from cash transfers. Quebec was the only province to choose these arrangements. The recoveries have no impact on net federal transfers or on Quebec's net receipts.

Direct Program Spending

Direct program spending consists of total program spending excluding the major transfers to persons and other levels of government. It includes subsidy and transfer programs administered by departments, expenditures related to Crown corporations, and operating, maintenance and capital spending by departments, including National Defence.

Subsidies and other transfers are expected to total $20.2 billion in 1999-2000, $19.6 billion in 2000-01 and $20.2 billion in 2001-02. They are higher than projected in the last budget, reflecting the impact of a number of initiatives announced since then.

- Many Canadian farmers, especially in parts of western Canada, are experiencing a significant decline in their incomes, largely due to factors beyond their control, such as the international decline in agricultural commodity prices. This crisis is having a devastating effect on their families and their rural communities. In response to this crisis, the Government provided $900 million in agricultural assistance under the Agricultural Income Disaster Assistance (AIDA) program in the 1999 budget. In November 1999, the Government announced that it would provide a further $170 million in 1999-2000 for AIDA. In January 2000, the Government announced that it would provide another $1 billion over the next two years to provide similar income disaster assistance to help farmers manage the production and market risks that they face. More recently, in response to continuing low prices and incomes, an additional $240 million in 1999-2000 is to be made available as soon as possible to some Prairie farmers. This amount will be matched by the traditional 60:40 ratio, which would mean $400 million would flow to farmers in particular need. Should grain prices and farm incomes not improve by 2002, additional funding may be considered for that year, provided an overall agreement with provinces has been reached on federal-provincial support for farmers.
- Since 1996, Canada has been a leader in developing the international initiative to provide relief for Heavily Indebted Poor Countries. However, the world's poorest countries' capacity to tackle poverty through initiatives in areas such as health and education remains constrained by the burden of servicing their debts. In support of this, Canada will provide $175 million to the multilateral debt relief funds managed by the International Monetary Fund and World Bank. In addition, Canada will provide 100-per-cent relief on debts owed to Canada by eligible developing countries that are making a real effort to improve the well-being of their citizens.

Debt reduction, while a critical element of assistance, will not by itself be sufficient to foster a lasting escape from poverty. Canadians understand the importance of development assistance to fighting poverty. In each of the last two budgets, incremental funding was provided to the International Assistance Envelope (IAE), which

encompasses both Official Development Assistance (ODA) and assistance to countries in transition in Central and Eastern Europe. This budget builds on those initiatives. Over the next three years, IAE funding will be increased by an additional $435 million. This is over and above funding for the International Climate Change initiatives described in Chapter 5, which also constitutes ODA.

In addition, increased efforts are required to promote peace and protect people from the instability and the insecurity created by war, conflict and acts of terrorism. Canadians are proud of Canada's role in seeking to eliminate land mines and create an International Criminal Court. This budget, therefore, provides an additional $10 million annually to the Department of Foreign Affairs and International Trade to help the Government further its human security agenda.

- Nearly half of the health transfers are for health-related services for First Nations and Inuit health services. In the 1999 budget, additional funding was provided to improve health information systems, promote health research and for preventive and other health initiatives.
- The decline in transfers administered by Human Resources Development Canada between 1998-99 and 1999-2000 reflects special one-time funding provided for the Canadian Fisheries Adjustment and Restructuring Program in 1998-99. The profile over the outlook period primarily reflects higher transfers under programs designed to improve access to post-secondary education – the Canada Student Loans Program, the Canada Study Grants and the Canada Education Savings Grant (CESG). The CESG was introduced in the 1998 budget as part of the Canadian Opportunities Strategy. Its success in helping parents and grandparents save for children's education has exceeded all expectations. Government contributions to individual registered education savings plan accounts are expected to reach about $750 million in 2000-01, nearly triple the amount expected at the time of the 1998 budget. In December 1999, the Government announced it would provide $753 million to help Canada's homeless persons. Of this amount, $432 million will be administered by Human Resources Development Canada and the remainder by Canada Mortgage and Housing Corporation.
- Transfers administered by Indian and Northern Affairs Canada are expected to increase over the outlook period. Population growth and the costs of providing services to First Nations and Inuit exceed those for the Canadian population at large.

- The increase in transfers under industry and regional agencies in 1999-2000 primarily reflects the payment of $900 million to the Canada Foundation for Innovation (CFI), which awards funds to help post-secondary educational institutions, research hospitals and not-for-profit institutions to modernize their research infrastructure and equip themselves for state-of-the-art research. The new funding in this budget, on top of the $1 billion provided in previous budgets, will support continued CFI awards until 2005. This budget also provides funding through the granting councils to establish and sustain the Canada Research Chairs.

- Most of the transfers administered by Veterans Affairs Canada are for pensions and allowances to veterans and others in recognition of the sacrifices they made while serving their country. In January 2000, the Government announced a special one-time payment to merchant marine veterans or their survivors to compensate for certain benefits that were not available on demobilization. Total compensation is to be capped at $50 million.

Other subsidies and transfers include assistance to support Canadian culture and identity, fisheries adjustment, and cost-sharing with the provinces and territories of juvenile justice services, among others. One of these is an increase in funding for the Canada Council of $10 million per year.

The 1999 Speech from the Throne made a commitment to increase support for the production of Canadian stories and images. To this end, the Government will work over the course of the coming year to modernize its support for feature films to improve the diversity and quality of Canadian films and reward success. As well, the administration of the tax credits that support film and television production will be simplified and strengthened.

Payments to Crown corporations consist of direct expenditures to appropriation-dependent Crown corporations and the annual profits and losses of enterprise Crown corporations. Over the outlook period, payments are expected to increase, reflecting transitional assistance with respect to certain Crown corporations administering their own employee pension plans as part of the reform of public service pension plans. Canada Mortgage and Housing Corporation will invest an additional $268 million in the Residential Rehabilitation Assistance Program as part of the Government's December 1999 announcement to help Canada's homeless persons.

Defence spending declined by over 20 per cent between 1993-94 and 1998-99, reflecting the impact of the restraint measures introduced in the 1994, 1995 and 1996 budgets. Despite these reductions, the Canadian Forces have continued to demonstrate an unwavering dedication, internationally and at home, in dealing with armed conflicts and natural disasters. In the 1999 budget, defence funding increased to address compensation and benefits. Funding was also made available during 1999-2000 to assist the military to meet Canada's international commitments in Kosovo. Funding for the next three years has also been increased to improve National Defence's ability to participate in peacekeeping activities, upgrade capital equipment and address quality of life issues within the military. Since the 1999 budget, an incremental $2.3 billion has been provided through 2002-03.

All other spending includes departmental operating and capital costs and centrally held funds to assist departments in managing unavoidable cost pressures. The increase between 1998-99 and 1999-2000 reflects, in part, the costs associated with addressing the Y2K computer problem in federal departments, as well as retroactive pay adjustments. Over the past year, the Treasury Board Secretariat conducted a major review of the Government's capacity to deliver existing programs. This review has resulted in increases in funding in a limited number of areas that are regarded as essential to the health and safety of Canadians or critical to the sustainability of high quality public services. Including funds earmarked for capital, this budget provides funding of $0.5 billion in 1999-2000, $1.2 billion in 2000-01, and about $1.0 billion in both 2001-02 and 2002-03 (Table 3.7). Examples of how these funds will be used include:

- Fisheries and Oceans is responsible for maintaining safety and security on Canada's waters and ensuring the sustainability of marine resources. The past several years have seen growing pressures on fish stocks, the introduction of new marine navigation technology and growing marine traffic. To help meet these challenges, Fisheries and Oceans will receive additional funding of $320 million over the next three years.
- The Government is committed to protecting the health of Canadians and finding new and better ways of responding to the emerging challenges to public health. Incremental funding is being provided to strengthen federal health protection activities such as

disease control and testing of food, drugs and natural health products. This budget also allocates additional funding to enable Health Canada to sustain existing services within the First Nations and Inuit health system. In total, this budget allocates $352 million over four years for initiatives in these areas.

- In the past year, Canada has experienced an unprecedented increase in the number of migrants attempting to bypass proper channels for entering the country. Allowing this illegal migration to continue would clearly compromise the integrity of the refugee determination and immigration systems. As well, there is a need to address new and emerging threats, including those from terrorism, to the security of Canada and its neighbours. The Government is therefore taking action to strengthen the control of Canada's borders.
  - Citizenship and Immigration Canada will receive incremental funding to meet challenges to the immigration and refugee determination systems.
  - The RCMP and Canada's security agencies provide vital law enforcement, anti-crime and security services. This budget will provide additional funding to strengthen federal policing and security activities, particularly in the area of organized crime, and improve policing services provided to provinces, territories and municipalities.
  - This budget provides additional funding to the Canada Customs and Revenue Agency to modernize its border management processes, fundamentally redesigning its customs practices. Streamlined processing of low-risk pre-approved imports and travellers will facilitate trade and travel and make Canadian business more competitive. This will allow the Agency to devote more resources to those enforcement activities that are most crucial to protecting Canada's borders.

Although additional funding is being provided for urgent operating and capital pressures, the Government will continue to operate in the most efficient and cost-effective manner possible. Under the Expenditure Management System, departments will still be required, to the greatest extent possible, to fund new cost pressures by internal reallocation and increased efficiencies.

Table 3.7
Providing Essential Public Services

	1999-2000	2000-2001	2001-2002	2002-2003	Cumulative total
	(millions of dollars)				
Defence	634	546	550	600	2,329
Furthering international co-operation	175	110	155	200	640
Economic adjustment					
Agriculture and Agri-Food Canada	586	511	500		1,597
Devco	75				75
Total	661	511	500		1,672
Operating and capital					
Citizenship and Immigration	209	208	89	74	579
Fisheries and Oceans		115	97	109	320
Foreign Affairs and International Trade	126	120	36	36	317
Health Canada	40	105	130	78	352
Justice		90	90	90	270
Public Works and Government Services	8	116	121	82	327
Solicitor General	72	231	272	307	883
Transport		52	41	46	139
Canada Customs and Revenue Agency		44	24	18	87
Veterans Affairs	50				50
Other		120	135	120	374
Total	505	1,200	1,035	960	3,699
Total	**1,974**	**2,366**	**2,240**	**1,760**	**8,340**
Total excluding capital	**1,974**	**2,167**	**2,039**	**1,560**	**7,739**

Note: Numbers may not add due to rounding.

Public Debt Charges

Based on the financial results for the first nine months of the year, public debt charges are estimated to total $41.5 billion for 1999-2000, slightly higher than in 1998-99 (Table 3.8). Over the outlook period it is assumed, for the purposes of projecting public debt charges, that the $3-billion Contingency Reserve would not be needed and would be used to reduce the public debt. The increase in public debt charges in 2000-01 and the subsequent reduction in 2001-02 reflect the expected increase in market interest rates and their subsequent easing.

Table 3.8
Public Debt Charges

	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002
	(billions of dollars)				
Public debt charges	40.9	41.4	41.5	42.0	41.5

Prudent and effective debt management are required to ensure that debt service costs and the Government's exposure to unexpected changes in interest rates and rollover risk are kept low. Greater cost stability has been achieved over the past several years by increasing the share of the Government's interest-bearing debt issued at fixed rates from about 50 per cent in 1992-93 to about two-thirds currently. A higher proportion of fixed-rate debt provides protection against unexpected changes in interest rates and brings the term structure of the debt in line with other major sovereign borrowers. In the early 1990s, the impact of a 100-basis-point increase in interest rates was estimated to raise public debt charges by $1.8 billion in the first year. Today the same increase in interest rates would increase debt charges by only $0.9 billion in the first year.

Taking into account the financial requirements forecast for 2000-01 (see below) and the desire to maintain a prudent debt structure and well-functioning Government of Canada securities market, the main financing operations – the bond and Treasury bill programs – are expected to operate at levels similar to 1999-2000. More detail on the Government's overall debt strategy will be available in the *Debt Management Strategy: 2000-01*, to be published by March 31, 2000.

Financial Requirements/Surplus

Financial requirements/surplus provides a measure of the net cash requirements needed to fund the Government's programs and debt charges. The difference between the financial requirements/surplus and the budgetary balance is due to a number of non-budgetary transactions (off-budget transactions) that provide funds to the Government. Non-budgetary transactions convert the accrual-based spending and revenue concepts in the budgetary balance to the cash-based financial requirements. The largest of the non-budgetary transactions are government employee pension accounts. Other smaller sources of funds include loans, investments and advances, cash in transit and accounts payable.

In 1998-99, there was a financial surplus (excluding foreign exchange transactions) of $11.5 billion (Table 3.9). This comprised a budgetary surplus of $2.9 billion and a net source of funds from non-budgetary transactions of $8.6 billion, most of which resulted from developments in the pension accounts. Of this amount $5.0 billion related to the federal public sector pension plans, with an additional $1.2 billion attributable to changes to the Canada Pension Plan (CPP). With respect to the CPP, changes to federal legislation are being proposed to allow the provinces to repay borrowings from the CPP at the market price.

For 1999-2000, a financial surplus of $8.0 billion is expected. This lower surplus reflects the assumption of a balanced budget and a lower source of funds from the pension accounts, primarily reflecting special adjustments in 1998-99 related to the reform of the public service pension plans.

For 2000-01, a financial requirement of $5.0 billion is expected, the first requirement in three years. Normally, non-budgetary transactions provide the Government with a net source of funds.

With the reforms of the public sector pension plans, effective April 1, 2000, the difference between the budgetary balance and the financial requirements/surplus will be permanently reduced. Government and employee contributions to the employee pension plans will now be invested in financial markets, rather than included as part of non-budgetary transactions. This will reduce the non-budgetary source of funds by at least $3.5 billion per year. In addition, a number of Crown corporations, which are currently members of the public sector pension plans, will be setting up their own pension plans. As such, there will be transfers of the applicable assets to these new plans.

There will also be a number of extraordinary cash payments in 2000-01 – the liabilities for which were included in the budgetary balance in prior fiscal years. These include payments associated with the pay equity settlement and the transfer of the CHST cash supplement to a third-party trust.

A financial balance is expected for 2001-02.

Table 3.9
Budgetary Balance, Non-Budgetary Transactions and Financial Requirements/Surplus[1]

	1998-1999	1999-2000	2000-2001	2001-2002
	(billions of dollars)			
Budgetary balance	2.9	0.0	0.0	0.0
Non-budgetary transactions				
Loans, investments and advances	0.5	0.0	-0.2	0.3
Pensions and other accounts	7.0	4.8	0.3	-0.5
Other	1.1	3.2	-5.1	0.2
Total	8.6	8.0	-5.0	0.0
Financial requirements/surplus	11.5	8.0	-5.0	0.0

[1] Excluding foreign exchange transactions.

Note: Numbers may not add due to rounding.

4

Better finances, better lives

Five-Year Tax Reduction Plan

Highlights

The 2000 budget proposes a five-year tax reduction plan that includes the most important structural changes to the federal tax system in more than a decade. The Plan will:

- immediately restore full indexation of the personal income tax system to protect taxpayers against automatic tax increases caused by inflation – this will benefit every Canadian; and
- reduce the middle income tax rate to 23 per cent from 26 per cent, starting with a 2-point reduction to 24 per cent in July 2000 – this will cut taxes for 9 million Canadians.

Additional key personal income tax measures of the Plan will:

- increase the amount that Canadians can earn tax-free to at least $8,000 and the amounts at which the middle and top tax rates apply to at least $35,000 and $70,000 respectively;

Highlights *(cont'd)*

- enrich the Canada Child Tax Benefit (CCTB) by $2.5 billion a year by 2004 to more than $9 billion annually – maximum benefits will reach $2,400 for a first child and $2,200 for a second child;
- eliminate, as of July 1, 2000, the 5-per-cent deficit-reduction surtax on middle-income Canadians with incomes up to about $85,000, and completely eliminate it by 2004; and
- raise to 25 per cent for 2000 and to 30 per cent for 2001 the permissible foreign content of investment in registered pension plans (RPPs) and registered retirement savings plans (RRSPs).

Additional measures will help Canadian businesses to become more competitive internationally by making the tax system more conducive to investment and innovation. To ensure continued growth and job creation in a global economy that is increasingly knowledge-based, the Plan will:

- reduce corporate tax rates to 21 per cent from 28 per cent within five years for the highest taxed business sectors, such as high-technology, beginning with a drop to 27 per cent effective January 1, 2001;
- reduce the corporate tax rate to 21 per cent from 28 per cent on small business income between $200,000 and $300,000 effective January 1, 2001;
- lower capital gains taxes by reducing the amount of capital gains included in income for tax purposes from three-quarters to two-thirds;
- postpone the taxation of gains on shares acquired under qualifying stock options to when shares are sold, rather than when the options are exercised; and
- allow a tax-free rollover of capital gains on qualified investments from one small business to another.

Highlights *(cont'd)*

The Plan, which places a special emphasis on the needs of families with children, will mean more money in the pockets of Canadians.

- Taxes will be reduced by a cumulative amount of at least $58 billion over five years.
- Personal income taxes will be reduced by an average of 15 per cent annually by 2004-05.
- Low- and middle-income Canadians will see their personal income taxes reduced by an average of 18 per cent.
- With substantially enriched benefits under the CCTB, families with children will see their personal income taxes reduced by an average of 21 per cent.

By 2004 a typical:

- one-earner family of four with about $35,000 of income will pay no net personal income tax;
- one-earner family of four earning $40,000 will see its net federal personal income taxes reduced by at least $1,623 a year, a reduction of 48 per cent; and
- two-earner family of four with income of $60,000 will see its net personal income taxes reduced by at least $1,546 a year – a reduction of 27 per cent.

Introduction

In the fall of 1999, the Government promised Canadians in the Speech from the Throne and *The Economic and Fiscal Update* that it would set out a multi-year plan for further tax reductions. With significant planning surpluses now available, this budget delivers on that commitment by making the most important structural changes to the Canadian federal tax system in more than a decade.

This Plan provides real and lasting tax reductions for Canadians and ensures that all taxpayers will see their taxes reduced in a manner consistent with the Government's main principles for cutting taxes, which are:

- first, the approach to tax reductions must be fair. Tax reduction must ultimately benefit all Canadians, but first it must benefit those who need it the most – middle- and low-income earners, especially families with children;
- second, broad-based tax reductions should focus initially on personal income taxes. That is where the burden is greatest – where Canadian taxes have been most out of line with other countries;
- third, the business tax system must be internationally competitive to enhance economic growth, increase productivity, raise wages and create jobs; and
- finally, broad-based tax reductions should not be financed with borrowed money.

The Plan in this budget will improve living standards for Canadians. It means more money in the pockets of Canadians, stronger economic growth and enhanced job creation.

Five-Year Tax Reduction Plan

Table 4.1 summarizes the Five-Year Tax Reduction Plan and indicates the amount of tax relief associated with each element of the Plan. By 2004-05, the Government will deliver an annual reduction in taxes of $17.6 billion.

The Plan will reduce taxes by a cumulative amount of at least $58 billion over the next five years.

Table 4.1 – OVERVIEW
Five-Year Tax Reduction Plan

Areas for action	Actions proposed to be implemented over the next five years	Amount of annual tax relief in 2004-05 (millions of dollars)
Eliminate automatic increases in the tax burden due to inflation	• Immediately restore full indexation of the tax system effective January 1, 2000	See below
	• Increase the amount of income Canadians can earn tax-free to at least $8,000 for the basic personal amount and at least $6,800 for the spousal/equivalent-to-spouse amount	2,760[1]
Reduce the high tax burden at the middle-income level	• Reduce to 23 per cent the 26-per-cent middle tax rate	3,600
	• Increase the level of income at which the middle tax rate begins to apply from $29,590 to at least $35,000	2,940[1]
	• Increase the level of income at which the top tax rate begins to apply from $59,180 to at least $70,000	730[1]
	• Eliminate the 5-per-cent surtax	865
Increase support for children	• Increase support for children under the Canada Child Tax Benefit over the course of the next five years, with maximum benefits rising to $2,400 for the first child	2,525[1]
Make the Canadian economy more internationally competitive	• Reduce the corporate income tax rate by 7 percentage points to 21 per cent from 28 per cent on business income not currently eligible for special tax treatment	2,995
	• Reduce the capital gains inclusion rate from three-quarters to two-thirds	295
	• Postpone taxation of gains on shares acquired under qualifying stock options to when shares are sold rather than when options are exercised	75
	• Allow tax-free rollover of capital gains on qualified investments from one small business to another	75
Other	• Technical measures including other indexation	780[1]
Total		17,640
Of which indexation contributes		6,215

[1] Amounts include indexation, based on an assumed annual inflation rate of 1.8 per cent.

Minimum $58 Billion Cumulative Tax Reduction Under the Five-Year Tax Reduction Plan

Size of Tax Relief (billions of dollars)

	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	Cumulative
Personal income tax	3.3	5.6	7.2	8.7	14.7	39.5
Corporate income tax	-0.1	0.3	0.5	0.5	2.9	4.0
Employment insurance (EI)	1.4	2.2	3.0	3.8	4.4	14.8
Total tax and EI relief	4.6	8.1	10.6	13.0	22.1	58.3

The $58 billion in tax relief is an absolute minimum, given the way this estimate is constructed. While an estimate of cumulative tax relief over five years, it: only includes actions legislated in the 2000 budget for the next two years; and assumes all remaining personal and corporate tax cuts take place in the fifth year.

To the degree these remaining actions are taken sooner – or tax reductions exceed those set out in the Plan – the cumulative tax relief would exceed $58 billion.

As an example, the size of cumulative tax relief would increase by almost $2 billion if the final point reduction of the middle tax rate were to occur earlier on July 1, 2002, rather than in the final year of the Plan.

As another example, the size of cumulative tax relief would increase by almost $1.5 billion if corporate tax reductions (from the 27-per-cent rate proposed to be legislated in January 2001) to 21 per cent occurred in the last two years rather than in the final year of the Plan.

Data sources:

1) Years 2000-01 to 2002-03 for personal income tax (PIT), corporate income tax (CIT) and EI: *The Budget Plan 2000*, Chapter 1, Table 1.4.
2) Year 2003-04 calculated as follows: PIT – cost of measures legislated in 2000 budget including indexation; CIT – same as 2002-03; EI – further assumed reduction of 10 cents in employee contribution rate.
3) Year 2004-05: PIT and CIT – Table 4.1 of this chapter; EI – further assumed reduction of 10 cents in employee contribution rate.

Note: Numbers may not add due to rounding.

Restoring Full Protection Against Inflation in the Tax System

To fully protect taxpayers against inflation, the budget proposes to restore full indexation of the personal income tax system effective January 1, 2000 (Table 4.2). This eliminates the provision put in place in 1986, that applied indexation to the personal income tax system only for inflation above 3 per cent.

Non-indexation of the tax system has resulted in ongoing automatic increases to the net tax burden (taxes minus benefits). There are several ways in which this happened:

- bracket creep, through which income is subject to higher tax rates even when real income or purchasing power does not increase; and
- the decrease in the real value of benefits such as the Canada Child Tax Benefit and the goods and services tax credit. There are two sources for the decline in real benefits: first, the reduction in purchasing power because of higher prices; and second, the reduction in the dollar amount of benefits as incomes rise with inflation.

Automatic Reduction in the Tax Burden From Indexation – Example 1

Sharon earns $25,000. Beyond the tax-free personal amounts, her income is subject to the lowest tax rate of 17 per cent. She also receives the goods and services tax (GST) credit and the Canada Child Tax Benefit (CCTB) for her son.

Each year, Sharon receives wage increases consistent with inflation from her employer, bringing her income to $27,250 by the fifth year.[1]

She has received no increase in real income. However, her real tax burden goes up automatically:

Net Federal Tax Payable in the Fifth Year (dollars)

	Non-indexed	Fully indexed	Difference
Tax	2,122	1,920	202
CCTB	1,278	1,663	385
GST credit	437	548	111
Total net tax (tax minus benefits)	**407**	**-291**	–
Net gain from indexation			**698**

Under the non-indexed tax system, Sharon would have paid $407 in net federal tax. Under a fully indexed tax system, she would be a net beneficiary receiving $291, effectively increasing her income by $698.

[1] An average annual rate of inflation of 1.8 per cent is used over the five-year period.

Automatic Reduction in the Tax Burden From Indexation – Example 2

Dale earns $35,000. Beyond the tax-free personal amounts, part of his income is subject to the lowest tax rate of 17 per cent, and the rest to the middle rate of 26 per cent. He also receives the GST credit and the CCTB for his two children.

Each year, Dale receives wage increases consistent with inflation from his employer, bringing his income to $38,150 by the fifth year.[1]

He has received no increase in real income. However, his real tax burden goes up automatically:

Net Federal Tax Payable in the Fifth Year (dollars)

	Non-indexed	Fully indexed	Difference
Tax	4,631	4,190	441
CCTB	1,612	1,929	168
GST credit	0	168	317
Total net tax (tax minus benefits)	**3,019**	**2,093**	**–**
Net gain from indexation			**926**

Under the non-indexed tax system, Dale would have paid $3,019 in net federal tax. Under a fully indexed tax system, he will pay $2,093, a tax saving of $926.

[1] An average annual rate of inflation of 1.8 per cent is used over the five-year period.

Although indexation will help all Canadians, it will benefit lower-income individuals the most. For example, Canadians with incomes under $30,000, who pay about 1 per cent of all net personal income taxes, will receive almost 40 per cent of the benefit from full indexation. Canadians with incomes up to $60,000, who pay about 40 per cent of all net personal income taxes, will receive 80 per cent of the benefits of indexation.

Indexation will particularly benefit middle- and low-income Canadians because:

- the effect of bracket creep stops building once a taxpayer has reached the income level at which the top tax rate begins to apply; and
- low- and middle-income taxpayers generally receive the benefits under the CCTB and the GST credit.

Reducing the Tax Burden for Middle-Income Canadians

Substantial Tax Cuts for Middle-Income Canadians

While tax burdens will fall for all Canadians, the decline will be substantially larger for middle-income Canadians as:

- the middle tax rate will drop;
- some incomes now subject to the middle tax rate will become subject to the lowest tax rate;
- some other incomes now subject to the top tax rate will face the middle tax rate;
- the 5-per-cent surtax will be eliminated July 1, 2000 for taxpayers with incomes up to about $85,000; and
- benefits under the Canada Child Tax Benefit will increase substantially.

Compared to other Western nations, Canada's personal income tax rate structure imposes higher taxes at middle-income levels. The increase in the personal income tax rate from low- to middle-income in Canada is the steepest among Group of Seven (G-7) countries.

The current federal tax rate structure was implemented in 1988. There are three federal tax rates applied to different income ranges:

- a 17-per-cent tax rate is applied to taxable income up to $29,590;
- a 26-per-cent tax rate is applied to taxable income between $29,590 and $59,180; and
- a 29-per-cent tax rate is applied to taxable income above $59,180.

Tax Rate Reduction

For the first time in 12 years, the Government will lower an income tax rate, specifically the middle tax rate, to 23 per cent from 26 per cent. As a first step, it is proposed that the rate drop 2 points – to 24 per cent – on July 1, 2000 (Table 4.2). The middle tax rate will drop further to 23 per cent within the next five years.

Because of the 2-point reduction in the middle tax rate, an average family of four will pay $600 a year less in personal income tax next year. When the cut is fully in place, it will pay $900 a year less.

Almost 9 million taxpayers will benefit from this measure.

Increase in Income Levels at Which Different Tax Rates Begin to Apply

The budget proposes to raise the amount that Canadians can earn tax-free, as well as the amounts that can be earned before the middle and top tax rates begin to apply, even more than would automatically result from indexation.

- Instead of $7,131, within five years Canadians will be able to earn up to at least $8,000 and pay no tax (Table 4.2).

Increasing tax-free amounts has been the first priority area for general tax relief for the Government since the elimination of the deficit because it delivers proportionally more tax relief to low-income taxpayers. By 2004, tax-free amounts will have increased by $1,544, or 24 per cent, since 1997. This will remain a priority area for further action should more resources become available.

- Instead of $29,590, within five years Canadians will be able to earn up to at least $35,000 and remain at the lowest tax rate of 17 per cent.
- Instead of $59,180, within five years Canadians will be able to earn up to at least $70,000 and remain at the new middle tax rate of 23 per cent.

Five-Per-Cent Deficit Reduction Surtax

Two surtaxes were introduced in the mid-1980s to reduce the deficit: after some changes in the early 1990s, all taxpayers were subject to the 3-per-cent general surtax, and taxpayers with incomes of over $65,000 were subject to an additional 5-per-cent surtax.

The 3-per-cent surtax was eliminated in the 1999 budget.

Effective July 2000, the budget proposes to eliminate the remaining deficit reduction surtax on Canadians with incomes up to about $85,000 (Table 4.2). As the surtax applies to tax otherwise payable and not on income, its elimination will lower the effective tax on income by 1.45 percentage points (5 per cent of 29 per cent).

The surtax will be eliminated for all Canadians over five years, benefiting 2 million Canadians. It is proposed that, effective January 2001, the rate be reduced to 4 per cent of tax payable on income above $85,000.

Foreign Content of Investment in Registered Pension Plans and Registered Retirement Savings Plans

Registered retirement savings plans (RRSPs) and registered pension plans (RPPs) provide the primary source of retirement income for middle-income Canadians.

Recently, a significant number of Canadians and organizations, including the House of Commons Finance and Senate Banking Committees and the Investment Funds Institute of Canada, have asked the Government to reconsider the current level for the limit on foreign property investments in RPPs and RRSPs. Appropriate limits in this area strike a balance between providing adequate opportunities for Canadians to diversify their retirement savings investments and ensuring that a substantial portion of these tax-assisted savings remains invested in Canada.

As a result, it is proposed that the permissible foreign content of investments in RPPs and RRSPs be raised to 25 per cent for 2000 and to 30 per cent for 2001. These increases will also apply with respect to the Canada Pension Plan.

Increasing Support for Middle- and Low-Income Families With Children

The 2000 budget proposes a further increase in the Canada Child Tax Benefit (CCTB) to help families with the added expense of raising children. Benefits will rise both because the CCTB will be fully indexed and because of proposed increases beyond indexation. These increases will build up to $2.5 billion annually by the fifth year to bring the CCTB to more than $9 billion annually.

Benefits for low-income families will rise by $1.3 billion. Of the total investment of more than $9 billion annually, about $6 billion will go to low-income families and about $3 billion to modest- and middle-income families.

The goal by the fifth year will be to raise the maximum CCTB benefit to $2,400 for the first child (with corresponding increases for subsequent children). The maximum benefit for the first child will increase in July 2000 to $2,056 from $1,805, reflecting the impact of actions in the 1999 and 2000 budgets. The maximum benefit will increase to $2,265 in July 2001 (Table 4.2).

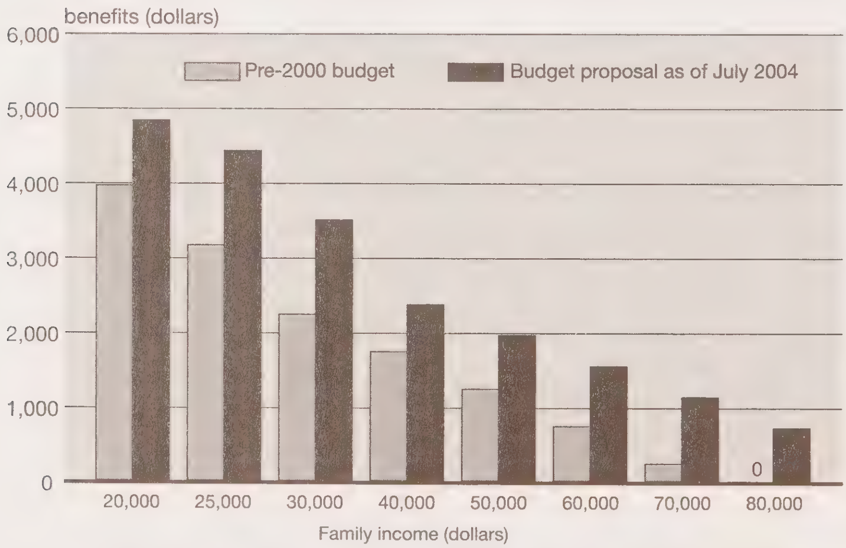
The budget proposes a number of steps, in addition to indexation of the CCTB, that will also benefit middle-income Canadian families. The base component of the CCTB will rise. The income level at which the base benefit begins to be reduced will go up with increases in the threshold at which the middle tax rate begins to apply (Table 4.2). Finally, the rate at which benefits decline with increases in income will be lowered.

As Chart 4.1 shows, the changes proposed in this budget will substantially increase benefits to middle-income families. For example, a two-child family with an income of $60,000 will see its CCTB benefit more than double from its pre-2000 budget level of $733 to $1,541 by 2004.

Chart 4.1

CCTB Benefits[1] by Income Level

(Two-child family with one child under the age of 7)



[1] Includes additional benefit available for children under 7 years of age for whom no child care expense is claimed.

Overall Size of Personal Income Tax Relief

On an annual basis, the Five-Year Tax Reduction Plan will reduce federal personal income taxes by an average of at least 15 per cent by 2004-05 relative to the taxes otherwise payable. Combined with the actions in the 1997, 1998 and 1999 budgets, annual personal income tax reductions will total 22 per cent by 2004-05. For families with children and for low- and middle-income Canadians (Chart 4.2), the Plan will reduce personal income taxes significantly more.

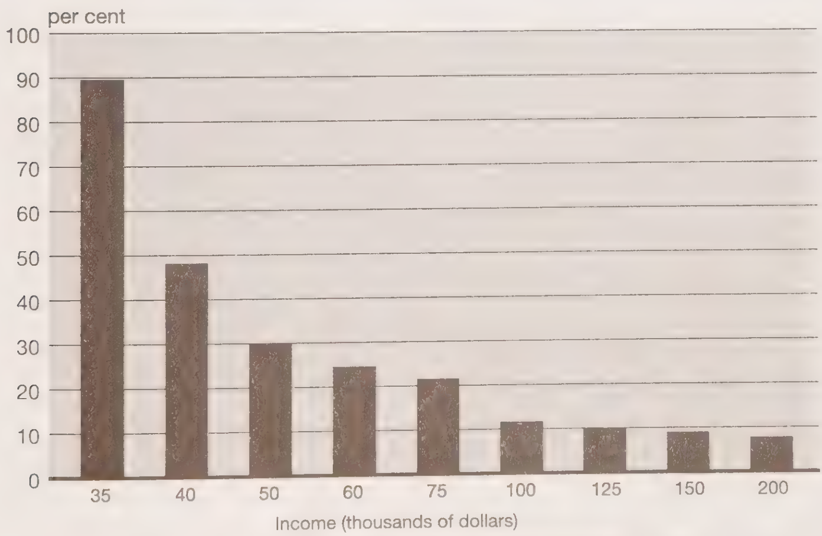
Percentage Tax Reduction by 2004-05

Annual tax reduction	Five-Year Tax Reduction Plan	Five-Year Tax Reduction Plan and 1997, 1998 and 1999 budgets
Average all Canadians	15	22
Families with children	21	30
Low- and middle-income Canadians	18	26

Note: Further details can be found in Annex 7.

Chart 4.2

Proportionate Tax Reductions Are Larger at Lower Incomes
(One-earner family of four)
Per cent tax reduction (2004)



Families of four earning under about $35,000 are net beneficiaries as they get more in benefits than the taxes that they owe.

Making the Economy More Internationally Competitive

Reduction in the Tax Rate for Highest Taxed Sectors

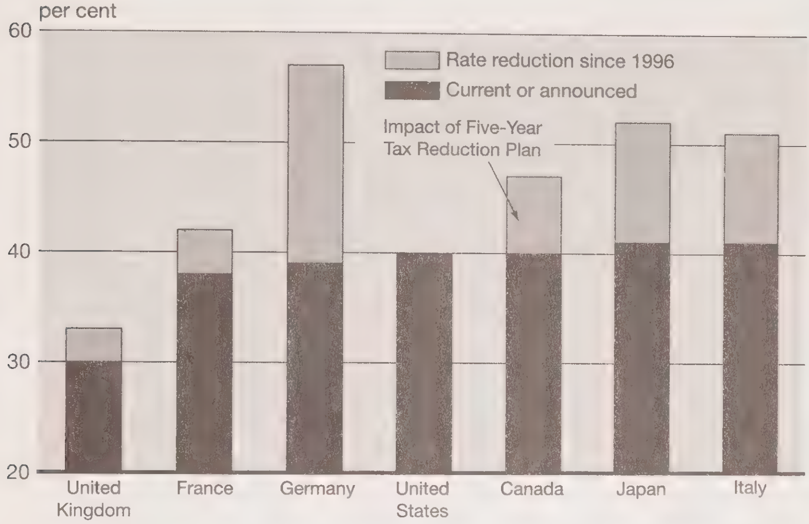
To prosper in the global economy, Canada needs a business tax system that is internationally competitive. This is important because business tax rates have a significant impact on the level of business investment, employment, productivity, wages and incomes.

Canadian effective tax rates for small businesses, the manufacturing and processing (M&P) sector and the resource sector are by and large internationally competitive. As a result of special tax preferences, small businesses effectively have a federal tax rate of about 12 per cent while the M&P and resource sectors have a federal tax rate of about 21 per cent. However, other sectors of the economy are subject to the high general corporate tax rate without any special provisions. These highest taxed sectors include fast-growing service and high-technology firms that will influence the pace of Canada's future economic and social development. In recent years, many industrialized countries have either reduced their corporate tax rates or announced their intention to lower them. If no action were taken, Canada's general corporate tax rate would not be competitive with those of our trading partners.

The Government's objective is to reduce, within five years, the federal corporate income tax rate to 21 per cent from 28 per cent on business income not currently eligible for special tax treatment. As a first step, the budget proposes to reduce this rate to 27 per cent effective January 1, 2001 (Table 4.2). Once fully implemented by 2004, the combined federal-provincial tax rate, including both income and capital taxes, would be reduced from the current average of 47 per cent to 40 per cent, a more competitive level vis-à-vis other G-7 countries (Chart 4.3).

Chart 4.3

Impact of Recently Announced General Corporate Tax Rate Reductions in G-7 Countries, Including Actions in the 2000 Budget[1] (Total Government)



[1] Rates effective by 2004, based on changes announced to February 2000. Rates include the income tax rate equivalent of capital taxes, where this information is available. The 2004 Canadian tax rate includes the reduced federal tax rate of 22.12 per cent (21 per cent plus the surtax) plus the average provincial tax rate of 14.3 per cent, plus a capital tax equivalent rate of 3.6 per cent.

Sources: *KPMG Corporate Tax Rate Survey* (January 2000); Ernst & Young International Tax Services; OECD Tax Database; Department of Finance calculations.

Faster Corporate Rate Reduction for Smaller Businesses

Given the important role of small businesses in Canada, the Government believes that, in addition to the personal income tax rate reductions, they should benefit from lower corporate tax rates more rapidly. Therefore, the budget proposes that, beginning January 1, 2001, small businesses would benefit from a 21-per-cent corporate tax rate on business income between $200,000 and $300,000 (Table 4.2).

This faster access to the reduced rate reflects the seriousness of this government's commitment to the small business sector.

Capital Gains

The high-technology sector and other fast-growing industries are particularly important to Canada's future economic growth. Our tax system must be conducive to innovation, and must ensure that businesses have access to the capital they need in an economy that is becoming increasingly competitive and knowledge-based. An examination of the taxation of capital gains in Canada suggests that this objective would be better achieved with a reduction in the inclusion rate of capital gains from the current three-quarters to two-thirds (Table 4.2). The budget proposes this change be effective after February 27, 2000.

Stock Options and Share Ownership

Many employers use share ownership plans and stock options to encourage employees to become participating owners of their businesses, most notably in the fast-growing high-technology industries. Tax rules that apply to stock options and employee share ownership plans have been under review to ensure that they remain appropriate as the economy evolves. As part of the review to date, it has been determined that, in the case of employee stock options granted by publicly traded companies, the current practice of taxing benefits when employees exercise their options may force some employees to sell the shares immediately to pay the tax. The budget proposes that employee stock options granted by publicly traded companies be subject to tax only when the employee sells the shares.

The budget proposes to defer the income inclusion from exercising employee stock options for publicly listed shares until the disposition of the shares, subject to a $100,000 annual vesting limit, effective for options exercised after February 27, 2000 (Table 4.2). The same dollar limit applies in the United States.

Consistent with the reduction in the inclusion rate for capital gains from three-quarters to two-thirds, it is further proposed that the deduction currently available for employee stock options be increased to one-third. The stock option deduction reduces the tax rate on benefits from employee stock options to the same level as the tax rate on capital gains.

These measures will provide employees with an added incentive to participate with their employers in the growth and success of their business.

Capital Gains Rollovers for Small Business Investors

Promoting innovation and growth also means ensuring that businesses have access to the risk capital they need to expand and prosper. This is particularly true for high-technology businesses, which are becoming increasingly important for innovation and economic growth. While the venture capital market has expanded considerably in recent years, start-up firms continue to have difficulty accessing risk capital because venture capitalists often focus more on established businesses. One factor that limits access to capital for small businesses is the fact that investors disposing of existing business investments to reinvest in other businesses must pay tax on the capital gains realized on the previous investment. This reduces the amount of money available for investment in new ventures.

The budget proposes that individuals be able to defer the tax on capital gains from eligible small business investments, to the extent that proceeds are reinvested in another eligible small business investment by the earlier of 120 days after disposition or 60 days after the end of the calendar year. Each new investment eligible for the rollover cannot exceed $500,000. Eligible small business investments are newly issued shares in a small business corporation with assets not exceeding $2.5 million before the investment is made and not exceeding $10 million after the investment. This tax deferral will be available for dispositions after February 27, 2000.

This measure, in combination with the reduction in the capital gains inclusion rate, improves access to capital for small businesses with high growth potential. This will be of particular benefit to the fast-growing high-technology industries.

Table 4.2
Summary of Budget 2000 Tax Measures

Areas for action	Actions proposed to be legislated through the 2000 budget	Amount of annual tax relief in 2004-05 (millions of dollars)
Eliminate automatic increases in the tax burden due to inflation	• Restore full indexation to the tax system effective January 1, 2000	See below
	• Indexation is expected to result in increases to the amount of income Canadians can earn tax-free to about $8,000 for the basic personal amount and $6,800 for the spousal/equivalent-to-spouse amount	2,015[1]
Reduce the high tax burden at the middle-income level	• Reduce to 24 per cent the 26-per-cent tax rate effective July 1, 2000	2,410
	• Increase the level of income at which the middle tax rate begins to apply from $29,590 to $32,000	1,885[1]
	• Increase the level of income at which the top tax rate begins to apply from $59,180 to $64,000	300[1]
	• Eliminate the 5-per-cent deficit reduction surtax for incomes up to about $85,000 effective July 1, 2000, and reduce the 5-per-cent surtax rate to 4 per cent on the tax payable on incomes above that level effective January 1, 2001	365
Increase support for children	• Increase the maximum Canada Child Tax Benefit: – to $2,056 by July 1, 2000 from $1,805 – to $2,265 by July 1, 2001 • Increase benefits to middle-income taxpayers through: – increases to the base benefit; and – increases to the level of income at which benefits begin to be reduced	2,175[1]

Table 4.2 *(cont'd)*
Summary of Budget 2000 Tax Measures

Areas for action	Actions proposed to be legislated through the 2000 budget	Amount of annual tax relief in 2004-05 (millions of dollars)
Make the Canadian economy more internationally competitive	• Reduce the corporate income tax rate to 27 per cent from 28 per cent on business income not currently eligible for special tax treatment effective January 1, 2001	455
	• Reduce the corporate income tax rate to 21 per cent effective January 1, 2001 on active business income between $200,000 and $300,000 earned by a small business	100
	• Reduce the capital gains inclusion rate from three-quarters to two-thirds	295
	• Postpone taxation of gains on shares acquired under qualifying stock options to when shares are sold rather than when options are exercised	75
	• Allow tax-free rollover of capital gains on qualified investments from one small business to another	75
Other	• Technical measures including other indexation	780[1]
Total		**10,930**
Of which indexation contributes		**6,215**

[1] Amounts include indexation, based on an assumed annual inflation rate of 1.8 per cent.

Examples of Tax Reductions for Typical Individuals and Families by 2004

Single Parent With One Child and an Income of $30,000: Tax Reduction by 2004

	Tax reduction/ benefits increase	Federal tax/benefits
	(dollars)	
Pre-2000 budget		
Tax		1,882
Canada Child Tax Benefit (CCTB)		1,415
Goods and services tax (GST) credit		499
Total net federal tax (tax minus CCTB and GST credit)		**-32**
Five-Year Tax Reduction Plan		
Reduction in tax	274	
Increase in CCTB	663	
Increase in GST credit	49	
Total net federal tax reduction	986	
Post-Plan net federal tax (tax minus CCTB and GST credit)		**-1,018**
First full-year impact (2001)		
Reduction in tax	72	
Increase in CCTB	281	
Increase in GST credit	20	
Total net federal tax reduction	373	

- The information provided above compares the benefits that would be received by a single parent, with one child, earning $30,000 in 2004 with and without the tax reductions provided by the Plan.
- Without taking into account the tax reductions proposed, this individual would have received $32 in total net benefits in 2004.
- By 2004, this single parent will receive $1,018 in total benefits, an increase of $986 in benefits.
- In 2001 alone, this single parent's net benefits will increase by $373.

Single Individual With an Income of $35,000: Tax Reduction by 2004

	Tax reduction/ benefits increase	Federal tax/benefits
	(dollars)	
Pre-2000 budget		
Total net federal tax		4,875
Five-Year Tax Reduction Plan		
Total net federal tax reduction	635	
Total net federal tax reduction (per cent)	13.0	
Post-Plan budget net federal tax		4,240
First full-year impact (2001)		
Total net federal tax reduction	214	
Total net federal tax reduction (per cent)	4.4	

- The information provided above compares taxes that would be paid by a single individual earning $35,000 in 2004 with and without tax reductions provided by the Plan.
- Without taking into account the tax reductions proposed, this individual would pay $4,875 in net federal personal income tax in 2004.
- By 2004, this individual will pay $4,240 in net federal personal income tax, a reduction of $635 or 13.0 per cent.
- In 2001 alone, this individual's federal taxes will be reduced by $214.

One-Earner Family of Four and an Income of $40,000: Tax Reduction by 2004

	Tax reduction/ benefits increase	Federal tax/benefits
	(dollars)	
Pre-2000 budget		
Tax		5,100
Canada Child Tax Benefit (CCTB)		1,733
Goods and services tax (GST) credit		0
Total net federal tax (tax minus CCTB)		**3,367**
Five-Year Tax Reduction Plan		
Reduction in tax	911	
Increase in CCTB	637	
Increase in GST credit	76	
Total net federal tax reduction	1,623	
Total net federal tax reduction (per cent)	48.2	
Post-Plan budget net federal tax (tax minus CCTB and GST credit)		**1,744**
First full-year impact (2001)		
Reduction in tax	347	
Increase in CCTB	235	
Increase in GST credit	0	
Total net federal tax reduction	582	
Total net federal tax reduction (per cent)	17.3	

- The information provided above compares taxes that would be paid by a one-earner family of four earning $40,000 in 2004 with and without tax reductions provided by the Plan.
- Without taking into account the tax reductions proposed, this family would pay $3,367 in net federal personal income tax in 2004.
- By 2004, this family will pay $1,744 in net federal personal income tax, a reduction of $1,623 or 48.2 per cent.
- In 2001 alone, this family's net federal taxes will be reduced by $582.

Two-Earner Family of Four and an Income of $60,000: Tax Reduction by 2004

	Tax reduction/ benefits increase	Federal tax/benefits
	(dollars)	
Pre-2000 budget		
Tax		6,656
Canada Child Tax Benefit (CCTB)		845
Goods and services tax (GST) credit		0
Total net federal tax (tax minus CCTB)		**5,811**
Five-Year Tax Reduction Plan		
Reduction in tax	812	
Increase in CCTB	734	
Increase in GST credit	0	
Total net federal tax reduction	1,546	
Total net federal tax reduction (per cent)	26.6	
Post-Plan budget net federal tax (tax minus CCTB and GST credit)		**4,265**
First full-year impact (2001)		
Reduction in tax	273	
Increase in CCTB	228	
Increase in GST credit	0	
Total net federal tax reduction	501	
Total net federal tax reduction (per cent)	8.6	

- The information provided above compares taxes that would be paid by a two-earner family of four earning $60,000 in 2004 with and without tax reductions provided by the Plan.
- Without taking into account the tax reduction proposed, this family would pay $5,811 in net federal personal income tax in 2004.
- By 2004, this family will pay $4,265 in net federal personal income tax, a reduction of $1,546 or 26.6 per cent.
- In 2001 alone, this family's net federal taxes will be reduced by $501.

Typical One-Earner Family of Four

Impacts of Proposed Five-Year Tax Reduction Plan by 2004

		Proposed tax reduction measures by 2004[1]								
Total income	Federal tax pre-2000 budget	Increase personal and spousal amounts	Increase 2nd and 3rd brackets	Reduce the middle rate	Eliminate surtax	Enhance Canada Child Tax Benefit	Other indexation	Total relief[2]	Total relief as a % of federal tax[3]	Federal tax post-Plan
$	$	$	$	$	$	$	$	$	$/%	$
15,000	-4,398	-173	0	0	0	-869	-55	**-1,097**	**-1,097**	-5,495
20,000	-3,601	-274	0	0	0	-869	-55	**-1,198**	**-1,198**	-4,799
25,000	-2,000	-274	0	0	0	-1,268	-55	**-1,597**	**-1,597**	-3,597
30,000	-37	-274	-37	0	0	-1,268	-172	**-1,751**	**-1,751**	-1,788
35,000	1,710	-274	-487	0	0	-594	-172	-1,526	-89.3	183
40,000	3,367	-274	-487	-150	0	-637	-76	-1,623	-48.2	1,744
50,000	6,467	-274	-487	-450	0	-723	0	-1,934	-29.9	4,534
60,000	9,592	-274	-512	-750	0	-809	0	-2,344	-24.4	7,248
75,000	14,783	-288	-852	-1,103	-2	-920	0	-3,165	-21.4	11,619
100,000	22,396	-288	-852	-1,103	-364	0	0	-2,607	-11.6	19,789
125,000	30,008	-288	-852	-1,103	-727	0	0	-2,970	-9.9	27,039

[1] In calculating the amount of the tax reduction by 2004, the following assumptions were made: annual inflation factor of 1.8 per cent on average is used over the five-year period; personal amount: $8,000; spousal/equivalent-to-spouse amount: $6,800; middle tax bracket threshold: $35,000; upper tax bracket threshold: $70,000; middle tax rate: 23 per cent; 5-per-cent surtax: eliminated; the Canada Child Tax Benefit base benefit increased by $70 in 2000 (including indexation) then indexed; the rate at which benefits decline with increases in income lowered to 2.07 per cent for a one-child family and 4.14 per cent for a family with two or more children; the threshold at which the base benefit starts to be reduced: $35,000; the National Child Benefit supplement increased by $200 per child by July 2001 (including indexation).

[2] Negative values indicate a reduction in net tax paid to the federal government.

[3] Where individuals and families receive more in federal refundable credits (CCTB, GST credit) than they pay in federal income tax, the federal income tax reductions are indicated in bold and represent the increase in the net benefits they receive from the tax and transfer system. Percentages are not meaningful so the dollar amounts are repeated.

Typical Two-Earner Family of Four

Impacts of Proposed Five-Year Tax Reduction Plan by 2004

		Proposed tax reduction measures by 2004[1]								
Total income	Federal tax pre-2000 budget	Increase personal and spousal amounts	Increase 2nd and 3rd brackets	Reduce the middle rate	Eliminate surtax	Enhance Canada Child Tax Benefit	Other indexation	Total relief[2]	Total relief as a % of federal tax[3]	Federal tax post-Plan
$	$	$	$	$	$	$	$	$	$/%	$
15,000	-4,571	0	0	0	0	-869	-55	**-924**	**-924**	-5,495
20,000	-4,503	-68	0	0	0	-869	-55	**-992**	**-992**	-5,495
25,000	-3,650	-287	0	0	0	-850	-55	**-1,192**	**-1,192**	-4,842
30,000	-2,366	-287	0	0	0	-1,230	-55	**-1,572**	**-1,572**	-3,938
35,000	-576	-148	0	0	0	-1,291	-172	**-1,611**	**-1,611**	-2,186
40,000	820	-295	0	0	0	-777	-172	**-1,244**	**-1,244**	-424
50,000	3,179	-295	-37	0	0	-648	0	-980	-30.8	2,199
60,000	5,811	-295	-487	-30	0	-734	0	-1,546	-26.6	4,265
75,000	9,822	-295	-487	-300	0	-863	0	-1,945	-19.8	7,877
100,000	15,794	-295	-863	-750	0	0	0	-1,909	-12.1	13,885
125,000	22,904	-303	-1,339	-1,358	-60	0	0	-3,059	-13.4	19,845

[1] In calculating the amount of the tax reduction by 2004, the following assumptions were made: annual inflation factor of 1.8 per cent on average is used over the five-year period; personal amount: $8,000; spousal/equivalent-to-spouse amount: $6,800; middle tax bracket threshold: $35,000; upper tax bracket threshold: $70,000; middle tax rate: 23 per cent; 5-per-cent surtax: eliminated; the Canada Child Tax Benefit base benefit increased by $70 in 2000 (including indexation) then indexed; the rate at which benefits decline with increases in income lowered to 2.07 per cent for a one-child family and 4.14 per cent for a family with two or more children; the threshold at which the base benefit starts to be reduced: $35,000; the National Child Benefit supplement increased by $200 per child by July 2001 (including indexation).

[2] Negative values indicate a reduction in net tax paid to the federal government.

[3] Where individuals and families receive more in federal refundable credits (CCTB, GST credit) than they pay in federal income tax, the federal income tax reductions are indicated in bold and represent the increase in the net benefits they receive from the tax and transfer system. Percentages are not meaningful so the dollar amounts are repeated.

Typical Single Individual

Impacts of Proposed Five-Year Tax Reduction Plan by 2004

		Proposed tax reduction measures by 2004[1]								
Total income	Federal tax pre-2000 budget	Increase personal and spousal amounts	Increase 2nd and 3rd brackets	Reduce the middle rate	Eliminate surtax	Enhance Canada Child Tax Benefit	Other indexation	Total relief[2]	Total relief as a % of federal tax[3]	Federal tax post-Plan
$	$	$	$	$	$	$	$	$	$/%	$
10,000	137	-148	0	0	0	0	-6	**-154**	**-154**	-18
15,000	899	-148	0	0	0	0	-27	-175	-19.5	724
20,000	1,695	-148	0	0	0	0	-27	-175	-10.3	1,520
25,000	2,492	-148	0	0	0	0	-27	-175	-7.0	2,317
30,000	3,529	-148	-37	0	0	0	-144	-329	-9.3	3,200
35,000	4,875	-148	-487	0	0	0	0	-635	-13.0	4,241
40,000	6,129	-148	-487	-150	0	0	0	-785	-12.8	5,345
50,000	8,729	-148	-487	-450	0	0	0	-1,085	-12.4	7,645
60,000	11,354	-148	-512	-750	0	0	0	-1,409	-12.4	9,945
75,000	15,864	-155	-852	-1,103	-60	0	0	-2,169	-13.7	13,695
100,000	23,477	-155	-852	-1,103	-422	0	0	-2,532	-10.8	20,945
125,000	31,089	-155	-852	-1,103	-785	0	0	-2,894	-9.3	28,195

[1] In calculating the amount of the tax reduction by 2004, the following assumptions were made: annual inflation factor of 1.8 per cent on average is used over the five-year period; personal amount: $8,000; spousal/equivalent-to-spouse amount: $6,800; middle tax bracket threshold: $35,000; upper tax bracket threshold: $70,000; middle tax rate: 23 per cent; 5-per-cent surtax: eliminated.

[2] Negative values indicate a reduction in net tax paid to the federal government.

[3] Where individuals and families receive more in federal refundable credits (GST credit) than they pay in federal income tax, the federal income tax reductions are indicated in bold and represent the increase in the net benefits they receive from the tax and transfer system. Percentages are not meaningful so the dollar amounts are repeated.

5

Better finances, better lives

Making Canada's Economy More Innovative

Highlights

- Investing in research and innovation through major new investments in the Canada Foundation for Innovation, the Canada Research Chairs initiative, Genome Canada and other existing research organizations, and Government On-Line, as well as through a more competitive tax system, new tax assistance for students and knowledge-based industries, and enhanced support for small business.
- Promoting environmental technologies and practices through initiatives such as the renewed Climate Change Action Fund, the Sustainable Development Technology Fund, a new Canadian Foundation for Climate and Atmospheric Sciences, new municipality-based initiatives for clean air and water, the National Strategy on Species at Risk and the Great Lakes Action Plan.
- Strengthening federal, provincial and municipal infrastructure in cities and rural communities across Canada.

Introduction

In the modern global economy, the nations that thrive will be those that excel at innovation. Building an economy that can innovate and compete with the rest of the world during a time of historic change requires a national effort and contributions from all public and private sector organizations.

Governments must provide the right economic, social and regulatory framework within which innovation can occur. Governments also need to ensure that opportunities exist for all citizens to have access to education, skills and knowledge and that the benefits of innovation are widely shared.

Further, a nation's potential for innovation is strongly linked to its research capacity. The ideas and talents of researchers at universities and research hospitals, government science facilities and non-profit institutions play a key role in building a country's knowledge base. Yet on their own, researchers cannot guarantee the kind of innovative and competitive economy Canada requires.

In the private sector, workers, entrepreneurs, managers and investors all play important roles in developing and marketing the knowledge that researchers create. The private sector must combine its entrepreneurial drive with the latest "know-how" and technology to create new products, processes and services. Firms that achieve success in the new economy must be prepared to risk investing in new skills and technologies, and the economic opportunities that flow from them.

However, new technologies are not just about generating economic opportunity. They also deliver new health care therapies, new solutions to environmental challenges such as climate change, and new approaches to the stewardship of natural resources. Thus, innovation and new ways of thinking about our environmental responsibilities will also help Canadians fulfill their desire for clean air, clean water and healthy habitats.

Finally, an innovative economy will not function without basic physical infrastructure that supports municipal services and allows people and goods to be moved safely and quickly. To that end, all orders of government share in the responsibility to renew Canada's infrastructure and find ways to increase its efficiency.

As Canadians continue to make the transition to the new knowledge-based economy, it is important to remember that creating a competitive, innovative economy is not an end in itself. Its worth rests on the opportunities it provides to Canadians, the health of the environment in which we live and the improvements it brings to our quality of life.

To help Canada become more innovative, the 2000 budget includes more than $4.1 billion worth of targeted investments in 1999-2000 and over the next three years that will:

- promote leading-edge research and innovation in universities, research hospitals and the private sector;
- support new environmental technologies and innovations; and
- strengthen federal, provincial and municipal infrastructure.

Investing in Research and Innovation

New ideas and the highly skilled people who can create them are increasingly crucial to Canada's efforts to develop a more innovative and knowledge-based economy. In recent budgets, the Government has invested in the federal granting councils and created the Canada Foundation for Innovation and the Canadian Institutes of Health Research.

Our university and research communities have enthusiastically received these initiatives, which are already beginning to show important returns on those investments. For example, these initiatives are helping to provide the funding, laboratories and networks that will lead to exciting opportunities for Canadian researchers and attract the best academic researchers in the world to Canadian universities.

However, experience is also showing that not all institutions of higher learning nor all regions of the country have the same capacity to exploit the opportunities that have been created. Efforts must be made to ensure that the Government's plan for innovation and skills can benefit Canadians in all regions. This point was made in the recently produced report *Catching Tomorrow's Wave*, which identifies the many opportunities that are available to Atlantic Canada as it continues to develop new and unique technology-based industries.

To further assist Canada's economy to become more innovative, the 2000 budget increases the Government's support for research. The budget will also encourage the growth of Canada's knowledge-based economy through measures that accelerate the provision of government information and services over the Internet to all Canadians. Finally, this budget includes measures to improve financing and other support for small and medium-sized businesses.

The Canada Foundation for Innovation

The Canada Foundation for Innovation was established in 1997. The Foundation awards funds to help post-secondary educational institutions, research hospitals and not-for-profit institutions modernize their research infrastructure and equip themselves for state-of-the-art research. The Government provided an initial $800 million to the Foundation and added $200 million in the 1999 budget. In the absence of additional funding, the Foundation's awards would end in 2001.

Therefore, the 2000 budget provides a further $900 million to the Foundation. This new funding brings the Government's total investment to $1.9 billion and will support continued awards until 2005. It will also help the Foundation meet the infrastructure needs of the new Canada Research Chairs initiative, which is described below.

To date, the Foundation has funded projects in every part of the country – reinforcing strengths in both small and large institutions, and creating new opportunities for established researchers and promising new researchers. About half the money awarded to date has been for health research.

Federal investments in the Foundation have attracted additional funding from provincial governments, universities and the private and voluntary sectors. Therefore, taking into account the funding added in this year's budget, the federal government's contributions to the Foundation will result in a total investment of about $5.5 billion in new research infrastructure, helping Canadians stay at the forefront of ingenuity and discovery.

Examples of Canada Foundation for Innovation Awards to Date

- $200,000 to a team from Vancouver General Hospital and the University of British Columbia for a leading research facility to help people with osteoporosis and cancer through research into bone reconstruction.
- $55,000 to Dalhousie University for equipment to research juvenile polycistic kidney disease, which affects approximately 27,000 people in Canada. Research is focusing on helping children on dialysis and transplant patients grow into healthy adults.
- $290,000 to the Montreal Neurological Institute to purchase a state-of-the-art DNA sequencer and protein purification equipment. Researchers are studying how cells in the nervous system communicate by releasing chemicals – opening doors to the treatment of psychiatric diseases such as schizophrenia.
- $100,000 to the University of Toronto to establish an Atmospheric Observatory to help researchers improve their understanding of the processes that cause ozone depletion and atmospheric pollution.
- $56.4 million toward the Canadian Light Source synchrotron project – a national facility designed by the University of Saskatchewan and supported by 18 other universities. This project, which will accelerate electrons to nearly the speed of light, will enable research leading to the development of new drugs and the creation of new materials.

Canada Research Chairs

Universities make an important contribution to research and innovation in Canada, but they face intense competition in attracting and retaining the best researchers. The Government has recently endorsed a plan from leaders in the research community to meet this challenge. As a result, the 2000 budget provides $900 million over five years through the granting councils to establish and sustain 2,000 Canada Research Chairs by 2004-05.

These new research positions will strengthen degree-granting institutions across Canada – from large universities with research strengths across a variety of disciplines to smaller institutions with more focused research capabilities. About half of these positions will be allocated to attract established world-class researchers, and the other half will support those who have demonstrated the potential to achieve world-class standing in their area of research.

The program's key objective is to encourage the building of a critical mass of world-class researchers in order to help Canadian universities achieve research excellence. Universities will develop comprehensive plans describing their research priorities and strategies. Applications from universities for individual positions will be evaluated against these strategic plans by review panels established by the granting councils.

From Memorial University in St. John's to the University of Victoria, the Canada Research Chairs will strengthen Canada's academic research base and help Canada play a leading role in natural sciences and engineering, health, and the social sciences and humanities. They will increase the capacity to generate new knowledge in every part of the country. This outcome is particularly important for Canada's smaller universities as they continue to develop their research programs. This initiative will encourage today's leading researchers to stay in Canada. It will also provide opportunities to promising young researchers from across Canada and attract researchers from around the world to pursue their careers in this country.

Enhanced Tax Assistance for Students

The Canadian Opportunities Strategy was introduced in the 1998 budget and expanded the following year. This Strategy will contribute more than $2 billion in each of the next two years to help Canadian families and students acquire knowledge and skills – for example, through Millennium Scholarships and Canada Study Grants.

The Canadian Opportunities Strategy helps families save for their children's education through registered education savings plans. It also facilitates life-long learning through tax-free withdrawals from registered retirement savings plans and helps students make the transition from school to work.

The 2000 budget enhances the Government's assistance for students by increasing from $500 to $3,000 the tax exemption for income from scholarships, fellowships and bursaries. This is the first time the $500 limit has been increased since 1972. This will increase federal tax assistance to students by about $30 million annually.

Genome Canada

Biotechnology is poised to be a major engine of the new economy and is expanding our understanding of all living organisms. Research in this field is creating new medicines, new tools for health diagnosis, more nutritious crops with higher yields and new technologies for cleaning up the environment.

Genomic science is key to the advancement of biotechnology. It is the study of the genetic code in people, plants and all other living things. This research has opened the door to continuing advances in the early identification and treatment of diseases such as cancer and cystic fibrosis.

Governments, universities, research hospitals and the private sector have all increased their investments in genomic science. However, there is still a need for more research infrastructure to support larger-scale projects. For this reason, Canadian researchers have proposed that the Government invest in a new non-profit corporation, Genome Canada, which will improve the co-ordination of research in genomic science.

In response, this budget will invest $160 million in Genome Canada to fund the activities of five genome science centres to be located in Atlantic Canada, Quebec, Ontario, the Prairies and British Columbia. These centres will provide laboratory services to researchers from universities, government and the private sector and serve as focal points to accelerate genomic research in Canada by giving researchers access to leading technologies. The centres will also support research into the social, ethical and legal issues related to genomic science.

Regulation of Biotechnology Products and Processes

Biotechnology products offer significant benefits to Canadian consumers and businesses. At the same time, they require careful scrutiny and regulation. Consequently, the Government is strengthening its commitment to ensure that these new technologies not only enhance health and safety, but also respect and preserve the environment. Specifically, this budget provides a permanent increase in the budgets of federal departments and agencies that regulate biotechnology developments. An additional $90 million will be invested over the next three years.

This investment will help Canada's regulatory system ensure that, before reaching the marketplace, biotechnology products are safe for human and animal health and the environment.

PRECARN

PRECARN is a national industry-led consortium that helps Canadian companies undertake research in artificial intelligence and advanced robotics. It acts as a facilitator in bringing together technology users, suppliers, developers and researchers. In this way, PRECARN works to keep Canada at the leading edge of breakthroughs in advanced manufacturing, mining, environmental cleanup and other activities using applications of advanced information technology.

PRECARN uses federal funds to match contributions from the private sector and provincial governments.

This budget will provide $20 million in 1999-2000 to support "Phase III" of PRECARN's program for research and development. Given the dramatic progress in artificial intelligence and advanced robotics technology during the last several years, the private sector and other research organizations will be well positioned to proceed beyond Phase III on their own.

Forestry Research Institutes and Geoscience

Canada's forest industry directly employs 384,000 Canadians and exports $40 billion worth of goods. It is a very capital- and technology-intensive industry that continues to adapt to the new economy. To help the industry continue to adapt, this budget provides $15 million for Canada's three forestry research institutes – Forintek, the Forest Engineering Research Institute of Canada, and the Pulp and Paper Research Institute of Canada.

These institutes are a vital part of Canada's research and development infrastructure and help Canada's forest industry improve productivity and become more innovative. They also provide technological solutions that are crucial to an ecologically sustainable and economically viable forest industry.

The mining sector is also an important part of Canada's economy. In order to ensure that Canada's geological information infrastructure continues to be state-of-the-art, this budget will

provide $5 million a year over three years for geoscience. By improving the quality of information available regarding new mining opportunities, this initiative will stimulate new investment in the mining sector.

Government On-Line

In the new economy, governments must use information and communication technologies to serve Canadians better. Citizens and businesses want service delivery that is more convenient, efficient, faster and organized according to their interests and needs. By being a model user of Internet technologies, governments will encourage more citizens and businesses to use the Internet. Over time, as more and more Canadians routinely use the Internet, the Government will be able to realize significant cost savings in program delivery. This budget will provide $160 million over two years to design and launch an initiative to offer federal government services on-line to Canadians and stimulate the use of electronic commerce, thereby building on the Government's plan to make Canada the most connected country in the world.

Another priority for the Government is to ensure the availability of Canadian cultural content on-line. Initiatives will include the digitization of collections and exhibitions of the National Archives of Canada, the National Library of Canada and related institutions so that Canadians will have access to them through the Internet. As well, a virtual museum will be created by linking the collections and exhibits of some 1,000 museums for on-line access by all Canadians. To this end, this budget allocates $20 million in 2000-01, growing to $30 million by 2002-03, to enrich Canadian content on the Internet.

A More Competitive Tax System

The 2000 budget proposes a number of tax changes that will be of particular benefit to fast-growing service and knowledge-based sectors. Specifically, the budget will:

- reduce the tax rate for highly taxed sectors. This will make Canada more attractive to domestic and foreign investors, and help service and knowledge-based firms expand and compete internationally;
- reduce the income inclusion rate of capital gains from three-quarters to two-thirds and allow a tax-free rollover for capital gains on qualified small-business investments to give businesses greater access to the capital they need to expand and prosper; and

- defer the income inclusion of benefits from employee stock options to help employees participate more fully in the business in which they work – an action that will be particularly helpful to the high-technology sectors.

This budget also introduces a five-year plan to reduce personal income taxes for all Canadians by:

- immediately restoring full indexation of the tax system to protect taxpayers against inflation;
- reducing the middle income tax rate to 23 per cent from 26 per cent;
- increasing the amounts at which the middle and upper tax rates apply, beyond indexation, to at least $35,000 and $70,000 respectively; and
- eliminating the 5-per-cent deficit reduction surtax.

Tax measures are described in detail in Chapter 4.

Enhanced Support for Small and Medium-Sized Businesses

The mandate of the Business Development Bank of Canada (BDC) is to help create and develop Canadian small and medium-sized enterprises (SMEs) by complementing services offered by other financial institutions. In recent years, the BDC has significantly increased its support for knowledge-based, export-oriented SMEs through various financing instruments, including quasi-equity and venture capital.

The Government will inject $80 million into the BDC – through the purchase of dividend-paying preferred shares – in support of the BDC's financing activities.

Like many other Canadians, rural Canadians are experiencing the challenge of economic adjustment and want to take advantage of new opportunities. In addition, they may face challenges related to the dependence of their local economy on a particular industry. To address these challenges, the existing Community Futures Program supports 252 Community Futures Development Corporations (CFDCs), which offer economic development support to small and rural communities. These corporations provide services such as mentoring, business counselling, training and loans to SMEs. Through these services, the Community Futures Program helps ensure that the benefits of the new economy are broadly realized throughout rural Canada.

This budget provides an additional $54 million over the next three years for the Community Futures Program. This funding will support the creation of new CFDCs and enhance services through increased operating funding to individual corporations.

Budget 2000: Supporting Small Business

Beginning in January 2001, small businesses currently paying tax at the general 28-per-cent rate will benefit from the new 21-per-cent corporate tax rate on business incomes between $200,000 and $300,000.

Other new tax measures will help small businesses gain access to the capital they need to expand and prosper. These include:

- reducing the income inclusion rate of capital gains from three-quarters to two-thirds; and
- allowing a tax-free-rollover of capital gains on qualified small business investments where they are reinvested in another small business.

The 2000 budget also enhances support for small and medium-sized businesses through non-tax measures such as:

- an $80-million injection into the Business Development Bank of Canada to support its financing activities for knowledge-based, export-oriented small businesses; and
- an additional $54 million over three years for the Community Futures Program, which delivers economic support to small and rural communities across Canada in the form of mentoring services, business counselling, training and loans.

Promoting Environmental Technologies and Practices

Canadians understand that clean air, clean water and healthy habitats are essential to a high quality of life. These priorities call for innovative ways of thinking about our collective environmental responsibilities. Canadians must co-operate in developing new technologies and practices that will be essential to their well-being in the 21st century.

It is in this spirit of co-operation that, in 1998, the federal government initiated consultations with other orders of government, the private sector and environmental groups to develop a National Implementation Strategy for Climate Change. This strategy, which

is expected to be developed by the end of the year, will outline a comprehensive plan to meet Canada's international climate change commitments.

In the meantime, to maintain momentum towards meeting Canada's climate change objectives, this budget provides $700 million between 1999-2000 and 2002-03 to preserve and improve Canada's natural environment, harness new technology and respond effectively to the challenges of climate change. These measures will be implemented in co-operation with provinces, municipalities, the private sector and non-governmental organizations.

Community Initiatives

The Federation of Canadian Municipalities and La Coalition pour le renouvellement des infrastructures du Québec have each worked on excellent proposals in the area of green infrastructure.

One proposal is the Green Municipal Enabling Fund to help communities assess where their environmental needs are the greatest. A second is a revolving fund, leveraging private sector investment in areas such as waste management and water conservation. This budget gives effect to both proposals. Municipalities will need to seek necessary authorities before accessing these funds. Specifically, this budget provides $25 million to help municipalities and communities determine the feasibility of and best approaches to renewable energy, building retrofit, water conservation, waste management and urban transit projects.

Secondly, this budget also creates a $100-million revolving fund – the Green Municipal Investment Fund – to support projects in areas such as energy and water savings, urban transit and waste diversion to strengthen the sustainability of communities. Loans from the fund will be repaid and then recycled to support new projects.

Projects will attract considerable funding from the private sector, including banks, utilities and other energy companies, and pension and other investment funds. For certain project categories, every dollar from the fund will be matched by about $10 from the private sector. Demonstration projects will be eligible for grants sourced from the fund's accumulated interest.

The administration of these two funds will be the responsibility of the Federation of Canadian Municipalities. The Federation will establish Councils to oversee the funds and advise the Federation's Board of Directors on specific project proposals. These funds will operate at arm's length from the federal government. Representatives from municipalities, the private sector, environmental groups and the federal government will participate in the Councils.

Sustainable Development Technology Fund

The development, dissemination and use of environmental technologies are essential as Canada makes the transition to a more environmentally benign information economy. To help Canada remain a world leader in environmental technology, the Government will establish a Sustainable Development Technology Fund at an initial level of $100 million. This fund will stimulate the development and demonstration of new environmental technologies, particularly those aimed at reducing greenhouse gas emissions such as fuel cells, wind turbines and advanced materials. Project funding would be available to the private sector, research centres and other institutes.

The fund's role will be twofold. First, it will support the development of promising new environmental and climate change technologies. Second, it will support the demonstration of these technologies so that they may be put to use throughout the economy.

Climate Change Action Fund

The Climate Change Action Fund (CCAF) was established by the federal government in 1998 to help Canada meet its international climate change commitments. It provides the framework for the federal government's priorities and actions in addressing climate change. The CCAF has laid the foundation for future greenhouse gas emission reductions by facilitating the development of technologies such as carbon storage and alternative fuels, and supporting local district energy projects. In this budget, new funding totalling $210 million over three years will be provided for the CCAF and other federal energy efficiency and renewable energy programs.

The federal government will also continue to show leadership by taking responsibility for its own emissions of greenhouse gases through renewed emphasis on energy efficiency and the use of renewable energy within government operations. For example, building on a successful initial purchase of green energy in Alberta, the federal government will expand this pilot initiative to procure $15 million of renewable energy over the next 10 years for federal facilities in Saskatchewan and Prince Edward Island. Over the next few years, the federal government will strive to increase its purchases of green energy for its facilities located in all regions of Canada.

Canadian Foundation for Climate and Atmospheric Sciences

The Government will also increase its support for academic research to address the impact of climate change and air pollution on human health. Specifically, this budget provides $60 million to fund the Canadian Foundation for Climate and Atmospheric Sciences, which will create a network among climate science institutes and universities across Canada. The Foundation will be created by the Canadian Meteorological and Oceanographic Society, which represents a broad community of scientists and Canadian scientific institutions. Based on a peer-review process, the new Foundation will provide research grants to teams of Canadian scientists over the next six years to strengthen Canada's climate research capacity and to encourage this capacity to remain in Canada.

International Environmental Initiatives

The Government is also supporting actions at the international level aimed at improving the global environment.

This budget provides Official Development Assistance funding of $100 million over four years through the Canadian International Development Agency for technology transfer and related initiatives to help developing countries reduce their greenhouse gas emissions and promote sustainable development.

In addition, this budget will invest $15 million to support the World Bank's Prototype Carbon Fund. Through this investment, Canada will contribute to new approaches to reducing greenhouse gas emissions through energy efficiency and renewable energy projects in both developing countries and economies in transition.

The Government will also provide funding of up to $20 million to help developing countries and economies in transition build their capacity to reduce and eliminate their releases of persistent organic pollutants. These are toxic substances, such as DDT and PCBs, that are transported through air and water and tend to concentrate in cold climates, including Canada's Arctic region.

National Pollution Enforcement and the Great Lakes Action Plan

The Government will provide funding for two other environmental initiatives to reduce pollution. First, in order to improve the federal government's capacity to ensure compliance with pollution control standards in all parts of the country, this budget will provide $22 million over three years and, in subsequent years, will stabilize funding at $9 million per year.

Second, the Government will expand its ongoing efforts to improve the environmental health of the Great Lakes Basin. This budget provides $8 million annually for the expansion of the Great Lakes Action Plan to assist in the cleanup of 16 areas of concern identified under the Great Lakes Water Quality Agreement between Canada and the United States.

National Strategy on Species at Risk

In recognition of the importance of protecting our natural heritage, the Government will commit $90 million over three years and, in subsequent years, will stabilize funding at $45 million annually to create a national strategy on species at risk. Under this strategy, the Government will introduce federal species protection legislation and stewardship programs, which will build on the work done with provincial and territorial partners under the Accord for the Protection of Species at Risk. This national strategy will protect species at risk and their critical habitat by funding recovery initiatives and species protection activities.

Ecologically Sensitive Lands

The protection of Canada's natural heritage is a critical component of the Government's approach to environmental issues. This is why the 1995 and 1997 budgets made significant improvements to the tax treatment of donations of ecologically sensitive land and

easements. Specifically, the 1995 budget provided that donations of ecologically sensitive land be exempt from the net income limits applicable to other types of donations, and the 1997 budget put forward a practical method for valuing easements for tax purposes.

Donations of ecologically sensitive land have grown significantly as a result of these budget measures, but environmental groups have recommended that more needs to be done to encourage donations. Accordingly, the budget proposes to reduce, from two-thirds to one-third, the income inclusion rate on capital gains arising from donations of ecologically sensitive land and easements. This will help Canada's landowners and conservation groups in their efforts to preserve Canada's natural heritage. For planning purposes, it is assumed that reducing the income inclusion rate will add $5 million to the annual cost of tax assistance for donations of ecologically sensitive land. However, it is important to point out that the cost of the measure will depend on the rate of donations, and thus on the willingness of Canadians to participate in the preservation of critical habitat.

Environmental and Sustainable Development Indicators

The federal government will provide $9 million over the next three years to the National Roundtable on the Environment and the Economy and to Environment Canada to develop environmental and sustainable development indicators in collaboration with Statistics Canada. These indicators will contribute to environmental policy making in a manner similar to the way in which economic indicators facilitate the Government's economic and fiscal management. Specifically, environmental indicators will provide a better basis for assessing the interactions between the economy and the environment and will improve Canada's ability to measure its progress on improving the environment.

Strengthening Federal, Provincial and Municipal Infrastructure

The 21st century economy requires a backbone of sound physical infrastructure to sustain the nation's growth and our quality of life. For example, Canadians deserve and expect a high standard of basic municipal services. It is also important to improve our capacity to move people and goods safely and quickly throughout the country.

However, in addressing Canada's economic priorities, governments must recognize the unique challenges confronting rural and remote communities. These include the difficulties faced by farm families on the Prairies and across the country, the anxieties of Canada's mining or other single-industry towns and the loss of traditional sources of employment on both coasts. People in these communities have the same needs as urban Canadians – quality health care and education, and work that is steady and well-paying. The difference in rural and remote communities is that a hospital restructuring, a school cutback or a factory closure can have a far greater impact – perhaps even threatening the viability of the community itself.

In addition, in many rural and remote communities, such concerns may be compounded by the anxiety that people's prospects are growing worse and that, in spite of better times, the overall benefits of the new economy will pass them by. Governments must not allow this to happen. Indeed, the new economy offers opportunities to rural Canada. In the year ahead, all orders of government must work to broaden and harness these opportunities so that the benefits of the new economy take root in all parts of the country.

With this in mind, the federal government will consult with other orders of government and the private sector to reach agreement on a creative and fiscally responsible multi-year plan to improve provincial highways and municipal infrastructure in cities and rural communities across Canada. An agreement is expected by the end of 2000.

In this budget, the federal government is allocating $100 million in 2000-01, $350 million in 2001-02 and $550 million per year for the next four years.

At the level of $550 million per year, $400 million will be allocated for municipal infrastructure in cities and rural communities across Canada, including affordable housing and green infrastructure, and up to $150 million for highways.

Separate from this initiative, the federal government's own infrastructure across the country needs improvement in order to address safety concerns and to maintain services to Canadians. This includes, for example, major repairs to federal bridges and wharves and the refurbishment of many federal laboratories. This budget provides a further $200 million per year over the next five years for these safety improvements.

Table 5.1
Making Canada's Economy More Innovative

	1999-2000	2000-2001	2001-2002	2002-2003	Cumulative total
	(millions of dollars)				
Investing in Research and Innovation					
Canada Foundation for Innovation	900				900
Canada Research Chairs		60	120	180	360
Enhanced tax assistance for students[1]		5	30	30	65
Regulation of biotechnology		25	30	35	90
Genome Canada	160				160
Forestry research institutes and geoscience	15	5	5	5	30
PRECARN	20				20
Community Futures		18	18	18	54
Government On-Line infrastructure		80	80		160
Canadian content for the Internet		20	25	30	75
Total	1,095	213	308	298	1,914
Promoting Environmental Technologies and Practices					
Community initiatives	125				125
Sustainable Development Technology Fund		100			100
Climate Change Action Fund/ energy efficiency and renewable energy			70	70	140
Green energy	15				15
Canadian Foundation for Climate and Atmospheric Sciences	60				60
International environmental initiatives	35	10	25	30	100
National pollution enforcement and the Great Lakes Action Plan		15	15	16	46
National Strategy on Species at Risk		20	30	40	90
Ecologically sensitive lands[1]		5	5	5	15
Environmental and sustainable development indicators		3	3	3	9
Total	235	153	148	164	700
Strengthening Federal, Provincial and Municipal Infrastructure					
Federal-provincial initiatives		100	350	550	1,000
Federal initiatives		200	200	200	600
Total		300	550	750	1,600
Total excluding tax initiatives	1,330	656	971	1,177	4,134
Total including tax initiatives	1,330	666	1,006	1,212	4,214

[1] Tax initiative.

Note: Numbers may not add due to rounding.

6

Better finances, better lives

Improving the Quality of Life of Canadians and Their Children

Highlights

Post-Secondary Education and Health Care

- Canada Health and Social Transfer (CHST) payments will be increased by $2.5 billion to help the provinces and territories fund post-secondary education and health care. This is the fourth consecutive federal enhancement of the CHST, providing an additional $1 billion in 2000-01 and $500 million in each of the following three years.
- Starting in 2000-01, CHST cash will reach $15.5 billion, almost 25 per cent higher than in 1998-99.
- The provinces and territories will have flexibility on when they draw upon the $2.5 billion that is being added to the CHST. They can draw upon it to meet the most pressing needs in universities and hospitals, or at any time over the course of four years, as they see fit.
- Total CHST, cash and tax transfers combined will reach an all-time high of close to $31 billion in 2000-01.

Highlights *(cont'd)*

Support for Families With Children

- In order to increase and broaden support for families with children, the Canada Child Tax Benefit will be increased by $2.5 billion a year by 2004, bringing to over $9 billion its annual support for low- and middle-income families with children. This will mean a maximum benefit of $2,400 for a first child and $2,200 for a second child.

- The duration of employment insurance maternity and parental leave will be doubled from six months to one year to give new parents the opportunity to spend more time with their newborn or newly adopted children. As well, the leave will be made more flexible and accessible. This measure will provide additional benefits of about $900 million a year.

- As in last fall's Speech from the Throne, the federal government invites the provincial and territorial governments to agree by December 2000 on an action plan to support early childhood development.

Assistance for Canadians With Disabilities

- Building on previous budget measures, the federal government will extend support and implement additional tax initiatives to expand opportunities for persons with disabilities, and help them deal with medical and care-related costs.

Introduction

The purpose of the plan outlined in this budget – sound financial management, lower taxes and investing in skills, knowledge and innovation – is to ensure that Canada will be a leader in the new world economy and that all Canadians will share in the benefits of economic growth. It is by these means that a continually improving quality of life will be secured for Canadians and their children.

Quality of life has many dimensions. It means access to timely and quality health care, and improved access to post-secondary education. Quality of life also means healthy children, secure families, vibrant communities and being able to learn and adapt. It includes sharing the benefits of economic prosperity with those who need special support for daily living or to participate in the job market. It also encompasses participation, particularly by youth, in community life and cultural and amateur sport activities. Amateur sport, because of its important role in the development of Canada's youth, should and will continue to receive government support.

Investments in quality of life are not just a matter of good social policy, they also represent sound economic policy.

With respect to health care and access to skills and knowledge, Canada's governments have a long-standing partnership. Most recently, in the 1999 budget, the federal government made its largest single investment ever: $11.5 billion over five years through the Canada Health and Social Transfer (CHST) to support provincial and territorial health care services, and $1.4 billion over three years for better health information, research and innovation, prevention and services. This budget increases CHST payments by another $2.5 billion to help the provinces and territories fund post-secondary education and health care. This is the fourth consecutive federal enhancement of the CHST.

The 1998 budget announced the $1.5-billion-a-year Canadian Opportunities Strategy to improve access to skills and knowledge through better financial assistance for students, support for research and lifelong learning, and incentives for families to save for their children's higher education. The 1999 budget added

$1.8 billion over three years in support of the Strategy as well as other knowledge and innovation measures. This budget adds further tax assistance for students and substantial new support for research.

With respect to children, the federal government has made a number of important investments in the past three years.

- In 1997, Canada's governments initiated the National Child Benefit System, an unprecedented partnership to combat child poverty by helping to protect benefits for low-income parents who enter and stay in the workforce. The federal government, for its part, has invested $1.7 billion a year in this system. The 1999 budget also provided an additional $300 million in support for modest- and middle-income families with children. This brings to $7 billion a year the total federal support to low- and middle-income families delivered through the Canada Child Tax Benefit.
- Canada's governments are also working on a National Children's Agenda to co-ordinate efforts of governments, communities and individual Canadians to make Canada a better place for all of its children.
- The federal government significantly enriched the Canada Prenatal Nutrition Program, the Community Action Program for Children and the Aboriginal Head Start Program.

This budget increases the Canada Child Tax Benefit by $2.5 billion a year by 2004, thus bringing to over $9 billion annual benefits for low- and middle-income families with children.

For persons with disabilities, the Government introduced the Opportunities Fund in 1997 as a pilot project to help Canadians with special needs prepare for, find and keep jobs. The Government also uses the tax system to help persons with disabilities participate as fully as possible in all aspects of life. This budget extends support and introduces new tax initiatives for persons with disabilities.

Increasing Support for Post-Secondary Education and Health Care

Action

$2.5 billion more in Canada Health and Social Transfer support for post-secondary education and health care.

Federal Transfers to Provinces and Territories

The federal government transfers approximately $40 billion a year to the provinces and territories through three major programs to help them provide vital services to Canadians:

- the Canada Health and Social Transfer (CHST), which supports health care, post-secondary education, social assistance and social services;
- Equalization, which provides extra funds to less prosperous provinces to enable them to offer public services that are reasonably comparable to those elsewhere in the country; and
- Territorial Formula Financing, which recognizes the unique challenges and higher costs of providing public services in the north.

Canada Health and Social Transfer

The CHST is the largest federal transfer, providing support in the form of cash and tax transfers to the provinces and territories. The federal government has already acted three times to strengthen the CHST. This budget announces a fourth consecutive enhancement of the CHST.

- In 1996, the Government took action to end the projected decline in CHST cash due to the growing value of tax transfers with the introduction of an $11-billion cash floor.
- In 1998, as soon as a balanced budget was at hand, the Government increased the CHST cash floor to $12.5 billion from $11 billion.
- In the 1999 budget, the Government announced the single largest investment it has ever made – an $11.5-billion increase in funding specifically for health care over five years (Table 6.1).

This increased CHST cash to $14.5 billion in 1999-2000. Combined with the value of tax transfers, total CHST is $29.4 billion this year – higher than in 1993-94 (Table 6.2).

This budget announces an additional $2.5 billion in CHST support, providing an added $1 billion in 2000-01 and $500 million a year in each of the following three years for post-secondary education and health care. Combined with last year's $11.5-billion investment, this means that the cash component of the CHST will reach $15.5 billion in each of the next four years. This represents an increase of almost 25 per cent from the 1998-99 level.

The $2.5-billion CHST supplement will be allocated to the provinces and territories on an equal per capita basis. The supplement will be accounted for by the Government in this fiscal year and paid into a third-party trust upon passage of amendments to the CHST legislation. However, the provinces and territories will have flexibility on when they draw upon the $2.5 billion that is being added to the CHST. They can draw upon it to meet the most pressing needs in universities and hospitals, or at any time over the course of four years, as they see fit. It is anticipated that the provinces and territories will draw down this supplement in a gradual manner such that cash support will increase by $1 billion in 2000-01, $500 million in 2001-02, $500 million in 2002-03 and $500 million in 2003-04 (Table 6.1).

At the same time, the tax transfer component of the CHST continues to provide increased support to the provinces and territories. The CHST tax transfer is an important part of the federal government's ongoing support for provincial and territorial social programs, including post-secondary education and health. The tax transfer occurred in 1977 when the federal government agreed with the provincial and territorial governments to reduce its personal and corporate income tax rates, allowing them to raise their tax rates by the same amount. As a result, revenue that would have flowed to the federal government began to flow directly to the provincial and territorial governments – and continues to grow in line with growth in the Canadian economy.

Table 6.1
Canada Health and Social Transfer (CHST)
1999-2000 to 2003-2004

	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004	5 years
			(billions of dollars)			
Budget 2000 increase[1]		1.0	.5	.5	.5	2.5
Budget 1999 increase	2.0	2.0	2.5	2.5	2.5	11.5
Includes:						
CHST		1.0	2.0	2.5	2.5	8.0
CHST supplement[2]	2.0	1.0	0.5			3.5
Budget 1998 cash	12.5	12.5	12.5	12.5	12.5	62.5
Total CHST cash	14.5	15.5	15.5	15.5	15.5	76.5
CHST tax transfers[3]	14.9	15.3	15.8	16.5	17.2	79.7
Total CHST	29.4	30.8	31.3	32.0	32.7	156.2

[1] The $2.5-billion cash supplement will be paid to a third-party trust and accounted for in 1999-2000 by the federal government. Payments will be made in a manner that treats all jurisdictions equitably, regardless of when they draw down funds over four years.

[2] The $3.5-billion cash supplement was paid to a third-party trust and accounted for by the federal government in 1998-1999.

[3] All figures for 2000-01 onward, with the exception of CHST cash, are projections.

Note: Numbers may not add due to rounding.

The $2.5-billion investment, combined with growing tax transfers, means that total support through the CHST will reach a new high of close to $31 billion in the coming fiscal year (Table 6.2).

Governments – both federal and provincial – recognize the need to ensure that the provision of health services continues to meet Canadians' needs in the future. This is of particular importance as Canada's baby boomers approach and then move into their senior years. To this end, federal and provincial health ministers have agreed to meet in the spring this year.

Table 6.2
Canada Health and Social Transfer (CHST)
1993-1994 to 2003-2004

	Cash[2]	Tax transfers[3]	Total
		(billions of dollars)	
CAP/EPF[1]			
1993-94	18.8	10.2	29.0
1994-95	18.7	10.7	29.4
1995-96	18.5	11.4	29.9
CHST			
1996-97	14.7	12.2	26.9
1997-98	12.5	13.3	25.8
1998-99	12.5	14.2	26.7
1999-00	14.5	14.9	29.4
2000-01	15.5	15.3	30.8
2001-02	15.5	15.8	31.3
2002-03	15.5	16.5	32.0
2003-04	15.5	17.2	32.7

[1] CAP – Canada Assistance Plan. EPF – Established Programs Financing.

[2] Based on an assumed gradual drawdown of the $2.5-billion cash supplement over four years starting in 2000-01 and of the $3.5-billion supplement over three years starting in 1999-2000.

[3] All figures for 2000-01 onward, with the exception of CHST cash, are projections.

Note: Numbers may not add due to rounding.

Growing Economy, Growing Transfers

The strong performance of the Canadian economy has significantly increased the value of other major transfers to the provinces and territories. Equalization to less prosperous provinces is up $500 million for this year over last year's budget projection, taking entitlements to $9.8 billion from the $9.3 billion previously projected. Territorial Formula Financing is nearly $100 million higher this year than projected, taking entitlements to about $1.4 billion from about $1.3 billion previously projected (Table 6.3).

Table 6.3
Total Federal Transfers to the Provinces and Territories 1993-1994 to 2003-2004

	CHST[1]	Equalization	Territorial Formula Financing	Total transfers[2]
		(billions of dollars)		
1993-94	29.0	8.1	1.2	37.4
1994-95	29.4	8.6	1.2	38.3
1995-96	29.9	8.8	1.2	39.0
1996-97	26.9	9.0	1.2	36.1
1997-98	25.8	9.7	1.2	35.7
1998-99	26.7	9.6	1.2	36.5
1999-00	29.4	9.8	1.4	39.4
2000-01[3]	30.8	9.5[4]	1.4	40.6
2001-02	31.3	10.0	1.4	41.6
2002-03	32.0	10.3	1.5	42.6
2003-04	32.7	10.7	1.5	43.7

[1] Cash plus tax transfers.

[2] Equalization associated with CHST tax transfers appears in both Equalization and CHST entitlements. The total has been adjusted to avoid double counting.

[3] All figures for 2000-01 onward are projections.

[4] First official Equalization estimate for 2000-01. Experience shows that first estimates generally tend to understate Equalization and are subsequently revised upward.

Note: Numbers may not add due to rounding.

Total transfers to the provinces and territories will reach an estimated $39.4 billion this year and will continue to grow over the next four years, allowing the provinces and territories to strengthen post-secondary education, health care and other social programs important to Canadians (Table 6.3).

Ensuring Access to Post-Secondary Education Through Canada Student Loans

The Canada Student Loans Program has played an important role in expanding access to post-secondary education since 1964. Through loans and other financial assistance, the program helps over 350,000 needy Canadian students annually access post-secondary education.

Canada Student Loans are administered and delivered, on behalf of the federal government, by financial institutions under an arrangement that expires on July 31, 2000. The federal government will take the necessary steps to ensure that the program continues to serve Canadian students after July 31, 2000.

Investing in Canada's Children

Actions

Canada Child Tax Benefit to increase by $2.5 billion a year by 2004, reaching $2,400 for a first child.

Families with children to benefit the most from the tax relief measures in the budget.

Duration of employment insurance maternity and parental leave to double from six months to one year to give new parents the opportunity to spend more time with their newborn or newly adopted children.

Federal government invites provinces and territories to develop together by December 2000 a national action plan on early childhood development.

Improved Support for Families With Children

Parents want the best possible start in life for their children. Current evidence suggests that the early years of childhood are especially vital to a child's future ability to develop and to learn. Governments help parents meet their children's needs in two basic ways: by providing them with income support and by offering a range of services.

To support parents and families, this budget further enriches the Canada Child Tax Benefit and significantly reduces taxes for low- and middle-income families with children. It also makes an important contribution to early childhood development by extending parental benefits and reiterating the invitation made in the 1999 Speech from the Throne for all governments to reach agreement by December 2000 on an action plan for early childhood development.

Canada Child Tax Benefit

The federal government's primary program for helping parents meet the costs of raising children is the Canada Child Tax Benefit (CCTB).

In its last three budgets, the federal government has increased its investment in the CCTB by a total of $2 billion, bringing the total annual commitment to $7 billion. Currently, the CCTB provides families with benefits of up to $1,805 for the first child and $1,605 for each additional child. Beyond a family income of $21,000, these benefit levels are gradually reduced. Families with incomes above $67,000 generally receive no benefits. At present, about 3.2 million families receive the CCTB, including some 80 per cent of children in Canada.

The plan set out in this budget is to add $2.5 billion a year to the CCTB by 2004, bringing the Government's total annual investment in the CCTB to over $9 billion. The goal, by 2004, is to raise the maximum amount of CCTB benefit to $2,400 for the first child and $2,200 for the second child. This will be done in several steps.

- First, this budget proposes to restore full indexation of the CCTB as of January 2000 so that its value keeps up with inflation. Although all families that receive the CCTB will gain from this measure, it will benefit low-income families proportionally the most.
- Second, this budget proposes to increase the CCTB in July 2000 by $70 per child, including indexation, for all families that receive the CCTB. When combined with the previous increase of $170 per child announced in the 1999 budget, which also takes effect in July 2000, maximum benefits will reach $2,056 for the first child and $1,853 for the second child.
- In July 2001, the CCTB supplement will be increased beyond indexation so that the total benefit for the first child reaches $2,265, on the way toward the final total benefit target of $2,400 by 2004.

- As well, over the next five years, the Government will take a number of steps to increase benefits for middle-income families. It will do so by increasing the income levels where families receive full benefits, and by reducing benefits more gradually for families with incomes beyond those levels.

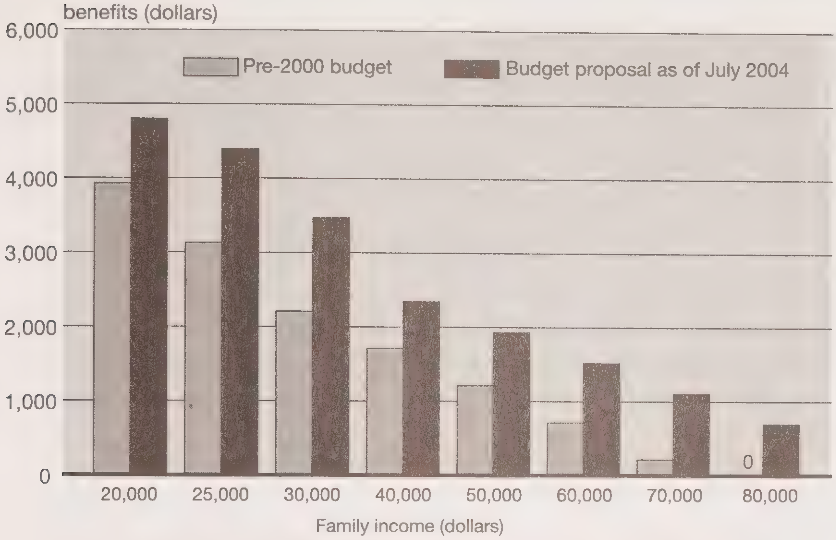
These measures will improve benefits for all families currently receiving the CCTB. Approximately $1.3 billion in increased support will go to low-income families. In the three previous budgets, about 85 per cent of CCTB increases, totalling $2 billion, were directed to low-income families, where needs were the greatest. With further improvements in the Government's finances, it is now possible to extend more of the CCTB increases to middle-income families with children: they will receive an additional $1.2 billion in benefits.

Overall, low-income families will continue to receive the greatest support from the CCTB. Of the total investment of more than $9 billion annually, $6 billion will go to low-income families.

As Chart 6.1 shows, benefits for a family with two children and income of $20,000 will increase from $3,963 to $4,832 by 2004. Middle-income families that now receive little or no support from the CCTB will see significant improvements as a result of the higher thresholds and the slower rates at which benefits will be reduced. For example, families with two children and an income of $60,000 will see their benefits more than double from $733 to $1,541 by 2004.

Chart 6.1

CCTB Benefits[1] by Income Level for a Two-Child Family
(With one child under the age of 7)



[1] Includes additional benefit available for children under 7 years of age for whom no child care expense is claimed.

Building on the National Child Benefit System

Since the 1997 landmark National Child Benefit (NCB) System, federal and provincial governments have acted together to combat child poverty by helping to protect benefits for low-income parents who enter and stay in the workforce. In the past, social programs have created a "welfare wall" – parents have had to choose between staying on welfare to retain important benefits for children or taking a job and losing child-related benefits.

To address this problem, in the 1998 budget, the federal government introduced an $850-million NCB supplement to the CCTB, targeted to low-income families. This supplement was increased by another $850 million in the 1999 budget. This enabled provincial governments,[1] in a co-ordinated movement, to adjust their income support programs and redirect funds in order to extend to low-income working parents a range of services and benefits for children formerly available only to families on welfare.

[1] The Government of Quebec chose not to participate in the NCB System but has acted on its own in a comparable way. In practice, Quebec residents have effectively benefited from the CCTB increases in the same way as other Canadians.

For example, in some jurisdictions, parents in low-paying jobs no longer lose services such as dental and vision care when they move from welfare to work.

Of the $2.5-billion CCTB increase outlined in this budget, a projected $850 million will go to the supplement. By July 2001, the supplement will be increased by $200 per child, increasing federal assistance to families by approximately $500 million annually. Thereafter, the supplement will continue to increase through indexation. By 2004, it is projected that indexation, plus an increase to $35,000 in the threshold at which the supplement is fully eliminated, will provide an additional $350 million. The federal government has consulted with provincial and territorial governments on the supplement and will continue discussions on provincial and territorial plans for further complementary investments in support of services for low-income families with children.

Total support for low-income families resulting from the enrichment of the CCTB will amount to a projected $1.3 billion by 2004. This is composed of the projected $850-million increase in the supplement and that part of the increase to the CCTB base benefit that goes to low-income families.

General Tax Relief for Families With Children

The increase in the CCTB in this budget is not the only measure benefiting families with children. They will also significantly gain from other general measures set out in the Five-Year Tax Reduction Plan.

Taking all these measures together, families with children will, on average, benefit from tax reductions of 21 per cent by 2004, compared to 15 per cent on average for all taxpayers.

- By 2004, a one-earner family of four earning up to about $35,000 will pay no net federal income tax.[2]
- By 2004, a one-earner family of four with $40,000 in income will have its taxes reduced by $1,623 or 48 per cent. Next year, its net federal income taxes will be reduced by $582.
- By 2004, a two-earner family of four with $60,000 in income will see its taxes cut by $1,546 or 27 per cent. Next year, this family's federal taxes will be reduced by $501.

[2] Net taxes are defined as taxes payable minus refundable tax credits (such as the CCTB and the goods and services tax credit).

Employment Insurance Parental Benefits

To assist parents in balancing work and family responsibilities, the Speech from the Throne made a commitment to give parents the opportunity to take more leave from work to spend with their newborn or newly adopted children. Parental leave under the employment insurance (EI) program will be extended and benefits made more flexible and more accessible.

Including the standard two-week waiting period for benefits, the EI program currently provides up to six months of maternity and parental leave benefits, made up of:

- 15 weeks of maternity benefits for recovery from child birth; and
- 10 weeks of parental benefits available to both adoptive and biological parents.

Maternity and parental benefits are similar to regular EI benefits: they range from 55 per cent of insurable earnings up to a maximum of 80 per cent for low-income families eligible for the Family Income Supplement. In 1998-99, the EI program provided $1.2 billion in maternity and parental benefits.

This budget proposes that the maximum amount of child-related leave be doubled to one year from six months (including the standard two-week waiting period). This will be done by increasing the number of weeks of parental leave (which can be claimed by either parent or divided between them) by 25 weeks, from 10 to 35 weeks. The extended benefits will be available to parents eligible for EI with a child born or adopted on or after December 31, 2000.

In addition, benefits will be made accessible to more parents by lowering the entrance requirements from 700 to 600 insurable work hours. Parents will now be eligible for benefits with as little as 12 hours a week of work over the course of a year. This eligibility change will apply to sickness benefits as well.

Further, parents will have greater flexibility in choosing whether one or both of them spend time at home with a new child. At present, when parents share the leave, two 2-week waiting periods apply. Under this proposal, the second waiting period will be waived.

Finally, parents will be allowed to work part-time while receiving parental benefits. This will help mothers make a gradual return to the workplace following their maternity leave, if they

so choose. It will also enable parents to maintain their skills and work contacts while taking parental leave. As is the case for regular EI benefits, they can have earnings of up to 25 per cent of their weekly benefit or $50, whichever is higher, without affecting their EI benefits. All earnings above that limit will be deducted dollar for dollar from their weekly benefit.

These changes will benefit an estimated 150,000 families each year. Their incremental cost is estimated at $900 million per year.

The Government will propose legislative changes so that permanent employees governed by the Canada Labour Code can benefit from the extension of parental leave by making sure that their jobs are protected during the extended leave periods. The federal Minister of Labour will continue to engage provinces in discussions over job security and parental leave.

National Children's Agenda

While parents and families have the primary role in raising children, communities and community groups all across Canada provide significant support as well. Governments collectively also have a supporting role.

All of Canada's governments – speaking through their First Ministers in 1997 – agreed to accelerate work on a National Children's Agenda. As a first step, governments[3] together released in May 1999 a *Vision Paper* to guide the efforts of all sectors of Canadian society – Canadians, communities, employers and governments – in better meeting the needs of children. This vision proposes six priority areas: strengthening the family, early childhood development, economic security, readiness to learn, adolescent development and supportive communities. The federal government will continue to work with provincial and territorial governments on these six areas.

Early Childhood Development

In October 1999, Canada's federal, provincial and territorial Ministers of Social Services undertook to work with their health colleagues to move forward as quickly as possible on the early childhood development component of the Children's Agenda.

[3] Although the Government of Quebec is not participating in the Agenda, it has stated that it agrees with its objectives.

As the next step in advancing the Children's Agenda, the federal government, as it did in its 1999 Speech from the Throne, invites all governments to work together to reach agreement by December 2000 on a national action plan to support early childhood development. This plan would set out common principles, objectives and fiscal parameters for all governments to increase their support for early childhood services.

Family Law

When families break up, the needs and best interests of children must be the highest priority. The 1996 budget announced the Child Support Initiative to benefit children by helping parents, lawyers and judges establish fair, predictable and consistent child support in divorce cases.

The federal government plans to work with the provinces and territories to improve family law so that it always puts the needs and best interests of children first. To facilitate this work, this budget allocates $29 million to extend for two years the financial assistance it provides to the provinces and territories for family-related services such as parenting information and skills development, mediation and court-based support programs.

Opportunities for Canadians With Disabilities

Action

Extended support and improved tax assistance for Canadians with disabilities.

Some Canadians have unique needs and require special support. Approximately 4.2 million Canadians – one in six Canadians of all ages – have a disability. The federal government is committed to helping Canadians with disabilities participate in the labour force and deal with medical and care-related costs. This budget builds on numerous measures in previous budgets.

Opportunities Fund for Persons With Disabilities

This budget provides $30 million a year to ensure continuation of the Opportunities Fund. The federal government introduced the Opportunities Fund in the 1997 budget as a pilot project to help persons with disabilities prepare for, find and keep jobs. The Fund has been well received by groups representing persons with disabilities. These groups have worked together with the federal and provincial governments and the private sector to develop projects that contribute to the Fund's objectives.

Health and Activity Limitation Survey

This budget provides funding of $11.5 million over three years for the Health and Activity Limitation Survey. The survey will be carried out as part of the 2001 national census by asking detailed questions to persons who indicate that they experience some level of disability. Similar surveys were done in the 1986 and 1991 censuses.

The survey provides information to help governments make more informed policy decisions on disability issues and evaluate the impact of programs over time. For example, it provides information on the use of and need for various disability supports, the employment patterns of persons with disabilities, their sources and levels of income, and barriers experienced in their working and everyday lives. Groups representing persons with disabilities have been closely involved in the design of the survey and have expressed support for its continuation.

Access to Canada Study Grants for Persons With Learning Disabilities

The federal government will ensure that no student with a severe learning disability who would otherwise be eligible for a Canada Study Grant[4] is denied access because of a lack of up-to-date documentation demonstrating the student's disability. The Government will recognize 75 per cent of the costs of one diagnostic assessment for learning disabilities (to a maximum of $1,200) as an eligible expense under the Canada Study Grant for persons with disabilities. Students will pay up front for the assessment and be reimbursed through the Grant.

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[4] See supplementary information at the end of this chapter.

Enhanced Tax Assistance for Persons With Disabilities

The federal government uses the tax system to help persons with disabilities meet expenses and participate as fully as possible in all aspects of life. The disability tax credit (DTC) provides tax relief in recognition of the general costs arising from a severe disability, while the medical expense tax credit (METC) recognizes specific medical- and disability-related expenses. In recent budgets, the federal government has substantially improved tax assistance for medical expenses and introduced a new tax credit for caregivers.

This budget provides increased tax relief to persons with disabilities by broadening and enhancing the DTC and recognizing additional specific disability-related expenses.

- A supplement to the DTC of up to $500 will be introduced to better recognize caregivers of children with severe disabilities. Eligibility for the DTC will also be broadened to include individuals with severe and prolonged disabilities requiring extensive therapy on an ongoing basis. Finally, the transfer rules for the DTC will be broadened to allow the transfer of unused amounts to an expanded list of supporting relatives (such as a brother, sister, aunt or uncle).
- In order to better recognize specific disability-related costs, the list of expenses eligible for the METC will be expanded to include the cost of modifications made to new homes to assist individuals with severe mobility impairments.
- To better recognize the generally higher costs of child care for children with disabilities, the limit on the child care expense deduction will be increased to $10,000 from $7,000 for children eligible for the DTC. To assist students with disabilities, the attendant care deduction will be expanded to include those attending an education institution.

These measures will increase tax assistance to persons with disabilities by an estimated $45 million annually.

Quality of Life and Security for Seniors

Canada's pension and health care systems make important contributions to the quality of life and security of Canada's seniors. Past actions of the federal government to put the public pension system on a sound financial basis, as well as tax relief provided in this and previous budgets, mean more financial security for today's and tomorrow's seniors. Similarly, investments in this and previous budgets provide provinces with growing resources to sustain and improve health care services.

Canada's governments have taken action to ensure that the Canada Pension Plan (CPP) is financially sound and provides a secure base on which Canadians can plan for their retirements. As well, Old Age Security (OAS) and the Guaranteed Income Supplement continue to provide basic income security for low- and middle-income seniors. These benefits are already fully indexed to inflation in recognition of the particular importance of this protection for Canadians in retirement.

The full indexation of the personal income tax system being provided in this budget will specifically help seniors through:

- Automatic increases in the age credit and the income threshold at which the credit is reduced.
  - The age credit currently provides up to $592 in tax assistance for a single senior and up to $1,184 for a senior couple. Benefits are reduced when income exceeds $25,921.
- Automatic increases of the income threshold where OAS benefits start to be reduced.
  - OAS benefits are currently reduced when income exceeds $53,215.

Over the course of the Five-Year Tax Reduction Plan outlined in this budget, seniors also benefit through:

- A reduction in the middle tax rate to 23 per cent, starting with a reduction to 24 per cent in July 2000.
- Automatic increases in the goods and services tax (GST) credit and the income threshold at which it is reduced.
  - The GST credit currently provides a maximum benefit of $304 for a single senior and $398 for a senior couple. Benefits are reduced when income exceeds $25,921.

- Increases in the amount individuals can receive tax free to at least $8,000.

  – The tax-free amount is currently $7,131.

- Increases in the income amounts at which the middle and upper tax rates begin to apply to at least $35,000 and $70,000 respectively.

  – The income amounts are currently $29,590 and $59,180.

By 2004, as a result of the Five-Year Tax Reduction Plan:

- A single senior with an income of $15,000 will have their net personal income taxes reduced by 84 per cent or $228.
- A senior couple with an income of $30,000 will have their net personal income taxes reduced by 45 per cent or $546.
- A senior couple with an income of $60,000 will have their net personal income taxes reduced by 16 per cent or $1,564.

Canadians know that they have a responsibility to prepare for their retirement. To do so, it is important for them to know what to expect from the public pension system.

In order for Canadians to make the best possible decisions regarding their personal savings for retirement, starting this year the Government will be sending to all CPP contributors annual statements of their contributions. As well, the Government is developing better information on the retirement income system; it will make this information available through these annual CPP mailings and other means.

To provide better opportunities for Canadians to diversify their personal retirement savings investments through registered pension plans and registered retirement savings plans, this budget proposes to raise the foreign content limit on those investments from 20 per cent to 25 per cent for 2000 and 30 per cent for 2001. This will also apply to the CPP.

With respect to health care, as outlined earlier, the federal government has made four consecutive investments in the Canada Health and Social Transfer to the provinces and territories. This means that in 2000-01, the transfer will reach an all-time high of close to $31 billion. As well, the federal government has made significant investments in this and recent budgets to advance research and innovation in the health care field and to provide better health information to Canadians.

Assisting the Homeless

Action

$753 million to help the homeless through partnerships with communities and federal initiatives.

In December 1999, the federal government announced a $753-million contribution to help Canada's homeless persons.

The cornerstone of the new approach is the Supporting Communities Partnership Initiative, to which the federal government will allocate $305 million of these funds over three years. Working closely with provincial and territorial governments, the federal government will help local communities design and put in place effective measures to help the homeless.

Funding for a range of existing federal programs will be increased to better serve the homeless and at-risk groups, including the Youth-at-Risk component of the Youth Employment Strategy, the Urban Aboriginal Strategy and the Shelter Enhancement Program. As well, the Canada Mortgage and Housing Corporation will invest an additional $268 million over five years in the Residential Rehabilitation Assistance Program to support necessary housing repairs on units occupied by low-income individuals.

Table 6.4
Improving the Quality of Life for Canadians and Their Children

	1999-2000	2000-2001	2001-2002	2002-2003	Cumulative total
		(millions of dollars)			
Post-Secondary Education and Health Care					
CHST cash supplement[1]	2,500				2,500
Support for Families With Children					
Canada Child Tax Benefit[2]		475	1,020	1,350	2,845
Parental benefits			571	916	1,487
Extension of parental leave to federal employees			21	34	55
Early Childhood Development		Discussions with provinces			
Family law			14	15	29
Total		475	1,627	2,315	4,417
Opportunities for Canadians With Disabilities					
Opportunities Fund		30	30	30	90
Health and Activity Limitation Survey		3	7	2	12
Access to Canada Study Grants for persons with learning disabilities	–	–	–	–	–
Enhanced tax assistance[2]		15	45	45	105
Total		48	82	77	207
Assisting the homeless	63	235	220	220	738
Total including tax initiatives	2,563	758	1,928	2,612	5,361
Total excluding tax initiatives	2,563	268	863	1,217	2,411

[1] CHST supplement will be accounted for in 1999-2000 and will be paid to a third-party trust, on passage of authorizing legislation. Expected drawdown by provinces and territories is described in this chapter.

[2] Tax initiative.

Note: Numbers may not add due to rounding.

Supplementary Information

Various Federal Child- and Youth-Related Programs[1]

Income Support

Child Care Expense Deduction

The Government provides to parents incurring child care costs about $520 million per year in tax relief. Parents who work or study may deduct from their incomes up to a maximum of $7,000 for a child under age 7 and up to $4,000 for children aged 7 to 15.

Equivalent-to-Spouse Credit

The Government provides to parents living alone with a child and who do not pay child support about $470 million annually in tax relief. For 2000, eligible parents are entitled to a tax credit of 17 per cent of $6,140. This value will increase with indexation.

Children's Special Allowances

To support children living in foster homes, about $80 million per year is paid to child care agencies on their behalf. An amount equivalent to the maximum Canada Child Tax Benefit (CCTB) is paid for each child in care. It will increase by $20 million as a result of the proposed CCTB enrichments.

Goods and Services Tax Credit for Children

The goods and services tax (GST) credit is intended to offset some or all of the GST paid by low-income families. It provides up to $105 per child. The value of the child-related portion of the GST credit exceeds $425 million per year. The budget proposes to fully index the GST credit levels and thresholds.

Employment Insurance Family Income Supplement

The Family Income Supplement, which provides about $110 million per year, is extended to employment insurance (EI) recipients who have children and an annual family income below $26,000. It raises the benefit rate to as much as 80 per cent of insurable earnings, compared to 55 per cent for other EI recipients.

[1] Unless otherwise specified, spending estimates are the best available estimates for 1999-2000.

Canada Pension Plan – Children's Benefits

The Canada Pension Plan (CPP) provides about $400 million a year in benefits in respect of children of CPP disability benefit recipients and children of CPP contributors who die.

Canada Education Savings Grants

The Canada Education Savings Grant assists parents saving for their children's higher education by providing a 20-per-cent top-up on the first $2,000 of annual contributions made to registered education savings plans for beneficiaries up to age 18. Grants from the federal government are expected to reach about $750 million next year.

Canada Millennium Scholarships

Each year for the next 10 years, up to 100,000 full-time students in universities, community colleges and CEGEPs will receive annual scholarships of $3,000. With an initial endowment of $2.5 billion, the Canada Millennium Scholarships will provide $300 million in scholarships annually for 10 years, reducing student debts significantly.

Canada Study Grants

To help students with the greatest needs, the Canada Study Grants provide up to $3,000 to over 30,000 post-secondary students with children. Study grants are also available for students with disabilities (up to $5,000), high need part-time students, and women pursuing doctoral studies.

Canada Student Loans

The Canada Student Loans Program extends on average $1.7 billion per year in loans to about 350,000 students pursuing post-secondary education. Changes introduced in the 1998 budget help students who have difficulty repaying their loans.

Tuition Fee Credit and Education Credit

To help post-secondary education students and the parents or others who support them, the tuition fee credit provides a 17-per-cent tax credit for students' tuition fees. In addition, an education credit is available, based on an amount of $200 per month for full-time students and $60 per month for part-time students. Together, these credits provided $850 million in assistance to students last year.

$3,000 Exemption for Scholarship, Fellowship and Bursary Income

The 2000 budget enhances the Government's assistance to students by increasing from $500 to $3,000 the tax exemption for income from scholarships, fellowships and bursaries. This provision, which will apply to Canada Millennium Scholarships and Canada Study Grants, among others, will increase federal tax assistance to students by about $30 million a year.

Credit for Payment of Interest on Student Loans

In order to ease the burden of student debt, a 17-per-cent tax credit is provided in respect of the interest portion of payments on Canada Students Loans and similar provincial student loan programs. This measure provided about $135 million in assistance last year.

Services

Canada Prenatal Nutrition Program

To help ensure pregnant women have healthy babies, the Canada Prenatal Nutrition Program provides $37.5 million annually in food supplementation, nutrition counselling and other services to at-risk pregnant women.

Community Action Program for Children

The Community Action Program for Children provides $56 million a year to community groups delivering services addressing the developmental needs of young children at risk. A similar program, called Brighter Futures, is directed at First Nations and Inuit children. It costs $76 million a year.

Aboriginal Head Start

The Aboriginal Head Start program helps prepare young Aboriginal children living on and off reserve for their school years. It costs $47.5 million annually.

First Nations – Education

The federal government provides about $900 million annually for instructional services for First Nations students residing on reserve and about $200 million per year for the construction and the maintenance of on-reserve school facilities.

First Nations – Social Services

The federal government provides about $270 million in support for on-reserve children in families relying on social assistance and about $240 million for other child and family services.

Cadet Program

The Cadet Program provides young people between 12 and 18 years of age with experiences in teamwork, leadership, time management and other skills. It costs about $140 million annually.

Youth at Risk

To help youth lacking job skills, the Youth at Risk program funds projects and other initiatives providing work experience to these young people. The federal government contributes about $150 million per year.

Youth Employment Strategy

The Youth Employment Strategy provides young Canadians with summer employment, internships, and career and labour market information services. The Government's investment in this program is $155 million a year.

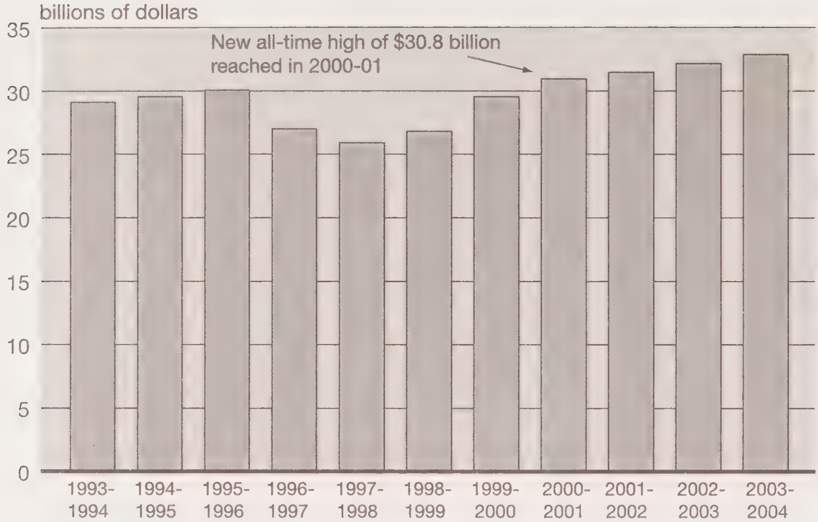
SchoolNet

SchoolNet helps to connect Canadian schools and classrooms to the Internet so that students benefit from the enhanced learning experiences that new technologies can provide. In the 1998 budget, the federal government provided $205 million over three years for connecting both schools and communities to the Internet through SchoolNet and the Community Access Program.

Chart 6.2

Canada Health and Social Transfer (CHST)[1]

1993-1994 to 2003-2004



[1] Includes $3.5-billion CHST supplement for health care as notionally allocated over three years in the 1999 budget. The $2.5-billion CHST supplement provided in this budget is notionally allocated over four years. Provinces and territories can draw it down at any time over the four years. All figures for 2000-01 onward are projections. Figures prior to 1996-97 are for transfers under the Canada Assistance Plan and the Established Programs Financing program.

Table 6.5

Projected Total Transfers to Provinces and Territories 1999-2000 to 2003-2004

	1999-2000	2000-2001[4]	2001-2002	2002-2003	2003-2004	5 years
			(billions of dollars)			
CHST cash[1] (current)	14.5	14.5	15.0	15.0	15.0	74.0
Budget 2000[2]		1.0	.5	.5	.5	2.5
Total CHST cash	14.5	15.5	15.5	15.5	15.5	76.5
CHST tax transfers	14.9	15.3	15.8	16.5	17.2	79.7
Total CHST	29.4	30.8	31.3	32.0	32.7	156.2
Equalization	9.8	9.5	10.0	10.3	10.7	50.3
Territorial Formula Financing	1.4	1.4	1.4	1.5	1.5	7.2
Total[3]	39.4	40.6	41.6	42.6	43.7	207.9

[1] Includes $3.5-billion CHST supplement for health care as notionally allocated over three years in the 1999 budget.

[2] The $2.5-billion CHST supplement provided in this budget is notionally allocated over four years. Provinces and territories can draw it down at any time over the four years.

[3] Equalization associated with CHST tax transfers appears in both Equalization and CHST entitlements. The total has been adjusted to avoid double counting.

[4] All figures from 2000-01 onward, except for CHST cash, are projections.

Note: Numbers may not add due to rounding.

Annex 1

Spending, Tax Relief and Debt Reduction Since the 1997 Budget

The following tables present the fiscal impact of the spending and tax relief initiatives since 1997-98 – the first year a budgetary surplus was recorded since 1969-70. They show the various initiatives undertaken in the 1998, 1999 and 2000 budgets, as well as cumulative totals.

Table A1.1 summarizes the fiscal impact of the initiatives over the period 1997-98 to 2002-03. In addition, it shows the reduction in public debt realized to date.

Tax relief since 1997-98 has been of two forms – tax expenditures and general tax relief. Tax expenditure measures include the Canada Child Tax Benefit, the education credit, credit for interest on student loans, and caregivers' credit, among others. While netted against revenues in the Government's financial statements, the tax expenditure measures in many respects share features similar to spending initiatives. They provide benefits to targeted groups – benefits which could be delivered through spending programs. In contrast, general tax relief affects the basic parameters of the income tax system and provides benefits to a large number of taxpayers. This includes changes to tax rates, the amount of income that a taxpayer can earn tax free and the elimination of the surtax. As a result, the overall allocation of the initiatives between spending, tax relief and debt reduction is affected by whether the tax expenditure measures are included as tax reduction or spending. Table A 1.1 shows it both ways.

Table A.1.1
Cumulative Amount of Spending, Tax Relief and Debt Reduction From 1997-98 to 2002-03

	Tax expenditures			
	as tax relief		as spending	
	billions of dollars	per cent of total	billions of dollars	per cent of total
Spending initiatives				
Improving the quality of life of Canadians	29.8	25.0	37.7	31.5
Making Canada's economy more innovative	17.6	14.7	19.3	16.1
Providing essential public services	7.7	6.5	7.7	6.5
Total spending initiatives	55.2	46.3	64.7	54.2
Tax expenditures and general tax relief				
Tax expenditures				
Making Canada's economy more innovative	1.5	1.2		
Improving the quality of life of Canadians	7.8	6.6		
Tax fairness measures	0.2	0.2		
General tax relief	32.1	26.9	32.1	26.9
EI premium reductions[1]	16.1	13.5	16.1	13.5
Total tax initiatives	57.6	48.3	48.1	40.4
Debt reduction	6.4	5.4	6.4	5.4
Total	**119.2**	**100.0**	**119.2**	**100.0**

[1] Assumes a 10-cent-per-year reduction in employee premium rates for 2001, 2002 and 2003. Actual rates are set each year by the Employment Insurance Commission.

Note: Numbers may not add due to rounding.

The cumulative amount of spending, tax relief and debt reduction over the 1997-98 to 2002-03 period is $119.2 billion. Including the tax expenditure measures as part of overall tax relief, new spending initiatives amount to $55.2 billion – 46 per cent of the total – tax relief amounts to $57.6 billion and there was $6.4 billion of debt relief – 54 per cent of the total. The debt reduction total only includes the actual reduction in public debt to date. To the extent that the annual $3 billion Contingency Reserve, included in the fiscal projections over the 1999-2000 to 2002-03 period, is not needed, the amount of debt reduction would increase correspondingly.

The ratios are reversed if the tax expenditure measures are included in spending.

With tax expenditure measures included in spending, the cumulative amount of spending initiatives is $64.7 billion – 54 per cent of the total – compared to general tax relief and EI premium rate reductions of $48.1 billion and debt reduction of $6.4 billion – 46 per cent of the total.

Table A.1.2
Spending and Tax Initiatives: February 2000 Budget

	1999-2000	2000-2001	2001-2002	2002-2003
		(millions of dollars)		
Spending initiatives				
Improving the quality of life for Canadians and their children				
Canada Health and Social Transfer[1]	2,500			
Support for families with children			607	965
Opportunities for Canadians with disabilities		33	37	32
Assisting the homeless	63	235	220	220
Total	2,563	268	863	1,217
Making the economy more competitive				
Investing and research and innovation				
Canada Foundation for Innovation	900			
Genome Canada	160			
Other	35	208	278	268
Total	1,095	208	278	268
Promoting environmental technologies and practices	235	148	143	159
Strengthening federal, provincial and municipal infrastructure		300	550	750
Total	1,330	656	971	1,177
Providing essential public services				
Defence	634	546	550	600
Economic adjustment	661	511	500	
Furthering international co-operation	175	110	155	200
Operating and capital	505	1,000	834	760
Total	1,974	2,167	2,039	1,560
Total spending initiatives	**5,867**	**3,091**	**3,873**	**3,953**
Tax expenditures and general tax actions				
Improving the quality of life for Canadians and their children				
Canada Child Tax Benefit		475	1,020	1,350
General tax relief and fairness measures				
Personal income tax relief		2,835	4,600	5,830
Corporate income tax reductions		-65	320	475
Fairness measures	-25	-55	-30	-25
Reduction in EI premium rates[2]	345	1,392	2,174	2,980
Total	320	4,107	7,064	9,260
Total tax initiatives	**320**	**4,582**	**8,084**	**10,610**
Total spending and tax initiatives	**6,186**	**7,672**	**11,957**	**14,563**

[1] The 1999-2000 CHST cash supplement will be paid into a third-party trust in 2000-01, on passage of authorizing legislation.

[2] Assumes a 10-cent-per-year reduction in employee premium rates for 2001, 2002 and 2003. Actual rates are set each year by the Employment Insurance Commission.

Note: Numbers may not add due to rounding.

Table A.1.3
Spending and Tax Initiatives: February 1999 Budget

	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003
	(millions of dollars)				
Building a secure society					
Strengthening health care for Canadians					
Canada Health and Social Transfer[1]	3,500		1,000	2,000	2,500
Other health care initiatives					
Improving health information systems	95	28	85	120	120
Promoting health-related research and innovation[1]	160	50	115	225	225
First Nations health services		20	60	110	110
Preventive and other health initiatives		49	104	134	134
Total	255	147	364	589	589
New partnerships with Aboriginal peoples		49	144	159	159
Crime prevention	13	95	128	159	159
Furthering international co-operation	187	55	80	80	80
Addressing environmental challenges	12	18	17	17	17
Other					
Equalization: technical improvements		48	97	145	194
Official languages in education		70	70	70	70
Parks Canada	35				
Compensation and benefit issues in the military		175	175	175	175
Total	4,002	658	2,074	3,393	3,942
Building a strong economy					
Building on the Canadian Opportunities Strategy					
Creating knowledge					
Canada Foundation for Innovation[2]	100				
Support for advanced research	16	50	55	55	55
Disseminating knowledge		27	42	27	27
Commercializing knowledge		121	232	317	317
Supporting employment		265	265	265	265
Total	116	463	594	664	664

Table A.1.3
Spending and Tax Initiatives: February 1999 Budget (cont'd)

	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003
	(millions of dollars)				
Economic adjustment					
Canadian Fisheries Adjustment and Restructuring Program	600	355	116	48	
Agriculture Income Disaster Assistance Program	600	285	15		
DEVCO	41	5	21	21	21
Total	1,241	645	152	69	21
Total: Building a strong economy	1,357	1,108	746	733	685
Total spending initiatives	**5,358**	**1,766**	**2,820**	**4,126**	**4,627**
Tax expenditures and general tax actions					
Building a secure society					
Increase in Canada Child Tax Benefit			225	300	300
General tax relief and fairness measures					
Extension of $500 supplement to all taxpayers		665	1,110	1,290	1,499
Increase in tax-free income by $175		270	450	525	613
Elimination of 3 per cent surtax		595	995	1,150	1,329
Tax fairness measures		15	25	100	100
Reduction in 1999 EI premiums[3]	300	1,250	1,250	1,250	1,250
Total	300	2,795	3,830	4,315	4,791
Total	**300**	**2,795**	**4,055**	**4,615**	**5,091**
Total spending and tax initiatives	**5,658**	**4,561**	**6,875**	**8,741**	**9,717**

[1] CHST supplement in 1998-99 was paid to a third party trust in 1999-2000.

[2] An additional $200 million is being allocated to the Canada Foundation for Innovation. It is expected that about half will be used to improve infrastructure for health research.

[3] Change from 1999 budget.

Note: Numbers may not add due to rounding.

Table A.1.4
Spending and Tax Initiatives: February 1998 Budget

	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003
			(millions of dollars)			
The Canadian Opportunities Strategy						
Millennium Scholarship Foundation	2,500					
Canada study grants	100	100	100	100	100	100
Increased funding for granting councils	120	135	150	150	150	150
Student Loans Program	50	145	150	158	158	158
Canada Education Savings Grant[1]		267	511	744	979	1,164
Connecting Canadians to information and skills	55	60	70	75	75	75
Supporting youth employment		50	75	100	100	100
Total	2,555	647	1,036	1,319	1,562	1,747
Building a secure society						
Increase in CHST cash floor	200	900	1,500	1,500	1,400	1,200
Other health initiatives						
National AIDS Strategy		41	41	41	41	41
Canadian Breast Cancer Initiative		7	7	7	7	7
Sustaining Canada's blood system[1]		55	55	25	25	25
Hepatitis C[1]	800					
Tobacco Demand Reduction Strategy		10	10	10	10	10
Total	800	113	113	83	83	83
Total	1,000	1,013	1,613	1,583	1,483	1,283
Support for families						
Increased funding for employability						
Assistance for persons with disabilities		15	20	20	20	20
New partnership with Aboriginal peoples	350	126	126	126	126	126
Promoting Canadian culture and sports	43	103	153	153	153	153
Strengthening communities		42	67	67	67	67
Environmental efficiency and innovation		94	94	94	94	94
Furthering international co-operation	90	70	20	20	20	20
Total	1,483	1,463	2,093	2,063	1,963	1,763
Total spending initiatives	**4,038**	**2,110**	**3,129**	**3,382**	**3,525**	**3,510**

Table A.1.4
Spending and Tax Initiatives: February 1998 Budget (cont'd)

	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003
	(millions of dollars)					
Tax expenditures and general tax actions						
The Canadian Opportunities Strategy						
Credit for interest on student loans		80	130	145	155	165
Life-long learning (RRSPs)		15	40	45	50	55
Part-time education tax credit (includes part-time CCED)		25	90	90	90	90
EI premium holiday for youth			100	100		
Total		120	360	380	295	310
Building a secure society						
Deductibility of health/ dental insurance premiums			90	110	125	125
Caregiver credit		30	120	125	130	130
Canada Child Tax Benefit			320	750	850	850
Child care expense deduction		20	45	45	45	45
Disability measures		5	5	5	5	5
Alternative minimum tax and RRSPs		70	20	20	20	20
Emergency services		5	10	10	10	10
Total		130	610	1,065	1,185	1,185
General tax relief and fairness measures						
Eliminate surtax for taxpayers up to $50,000		710	1,175	1,365	1,430	1,498
Tax relief for low-income taxpayers		170	270	315	330	346
Reduction in EI premiums[1]	235	725	725	725	725	725
Tax fairness measures		-5	-25	30	35	41
Total	235	1,600	2,145	2,435	2,520	2,610
Total targeted and general tax actions	**235**	**1,850**	**3,115**	**3,880**	**4,000**	**4,105**
Total spending and tax actions	**4,273**	**3,960**	**6,244**	**7,262**	**7,525**	**7,615**

[1] Revised from February 1998 budget.

Note: Numbers may not add due to rounding.

Table A.1.5
Summary of Spending and Tax Actions in 1998, 1999 and 2000 budgets

	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	Cumu-lative total
	(millions of dollars)						
Spending initiatives							
Building a secure society							
Strengthening health care for Canadians							
Canada Health and Social Transfer	200	4,400	4,000	2,500	3,400	3,700	18,200
Other health initiatives	800	368	260	447	672	672	3,218
Other	483	697	1,054	1,458	2,147	2,550	8,388
Total	1,483	5,465	5,313	4,405	6,219	6,921	29,806
Building a strong economy							
Canadian Opportunities Strategy	2,555	763	2,829	2,569	3,197	3,588	15,501
Economic adjustment		1,241	645	152	69	21	2,128
Total	2,555	2,004	3,474	2,721	3,266	3,609	17,629
Providing essential public services			1,974	2,167	2,039	1,560	7,739
Total spending initiatives	**4,038**	**7,469**	**10,761**	**9,292**	**11,523**	**12,089**	**55,173**
Tax expenditures and general tax relief							
Canadian Opportunities Strategy		120	360	380	295	310	1,465
Building a secure society							
Canada Child Tax Benefit			320	1,450	2,170	2,500	6,440
Other		130	290	315	335	335	1405
General tax relief		880	2,975	7,005	9,645	11,590	32,095
Tax fairness measures		-5	-35	0	105	116	181
EI premium reductions	235	1,025	2,320	3,367	4,149	4,955	16,050
Total	**235**	**2,150**	**6,230**	**12,517**	**16,699**	**19,805**	**57,636**
Total spending and tax initiatives	**4,273**	**9,619**	**16,991**	**21,809**	**28,213**	**31,895**	**112,809**

Note: Numbers may not add due to rounding.

Annex 2

The Budgetary Balance, Financial Requirements/ Surplus, and the National Accounts Budget Balance

There are three basic measures of the federal government's fiscal position – two are based on the Public Accounts (the budgetary balance and financial requirements/surplus) and one on the System of National Accounts, as prepared by Statistics Canada.

Differences in the measures arise because the accounting frameworks are designed for different purposes.

The fundamental purpose of the Public Accounts is to provide information to Parliament on the Government's financial activities as required under the Financial Administration Act. The Public Accounts are based on generally accepted accounting principles for the public sector (as recommended by the Public Sector Accounting and Auditing Board) and are audited by the Auditor General of Canada.

The financial requirements/surplus, excluding exchange fund transactions, measures the difference between cash payments by the Government and cash receipts. It is roughly equivalent to the amount of money that the Government has to borrow in credit markets or the amount of market debt that the Government is repaying. However, in any one year, changes in the Government's cash balance and foreign reserve position can also have an effect on the level of market debt.

In essence, the budgetary balance includes obligations incurred by the federal government during the course of the year, whereas the financial requirements/surplus includes only the actual cash outlay related to these obligations.

The main difference to date between the budgetary balance and the financial requirements/surplus is the treatment of federal government employees' pension accounts. The budgetary balance includes the total annual pension-related obligations (the Government's contribution as an employer for current service costs plus interest on its borrowings from the pension accounts) while the financial requirements/surplus includes only the benefits paid out in that year less employee premiums paid. In 1998-99, the federal employees' pension funds accounted for $5.0 billion of the $8.6 billion difference between the budgetary balance and financial requirements/surplus.[1]

Most industrialized countries present their budgets on a basis that is more comparable to the financial requirements/surplus than to the Public Accounts measure of the budgetary balance. The financial requirements/surplus corresponds closely to the Unified Budget Balance in the United States.

The primary objective of the National Accounts is to measure current economic production and income. The government sector in the National Accounts is treated on the same basis as other sectors of the economy. As such, only tax revenues collected on income generated in the current year are included as revenues, and only spending which relates to economic activity in the current year is included as expenditures. The current National Accounts and the financial requirements/surplus treat the transactions of federal government employees' pension accounts similarly.

- National Accounts balances are used for international fiscal comparisons by the Organisation for Economic Co-operation and Development and the International Monetary Fund.
- The National Accounts also provide a consistent framework for aggregation and comparison of the fiscal positions of the various levels of government in Canada.

[1] The recent legislated reform of the federal employee pension plans will significantly narrow this difference in the future. Effective April 1, 2000, contributions to the plans will be invested in the market, thereby reducing the difference between the budgetary balance and financial requirements/surplus by about $3.5 billion.

The budgetary balance (deficit or surplus) is the most comprehensive of the three measures. It includes all financial transactions between the Government and outside parties. It also includes liabilities incurred during the year for which no cash payment has been made.

Each of the three measures provides important complementary perspectives on the Government's fiscal position. Although the measures differ in their levels, their trends are broadly similar (Chart A2.1 and Table A2.1).

Chart A2.1

Alternative Measures of the Federal Budget Balance

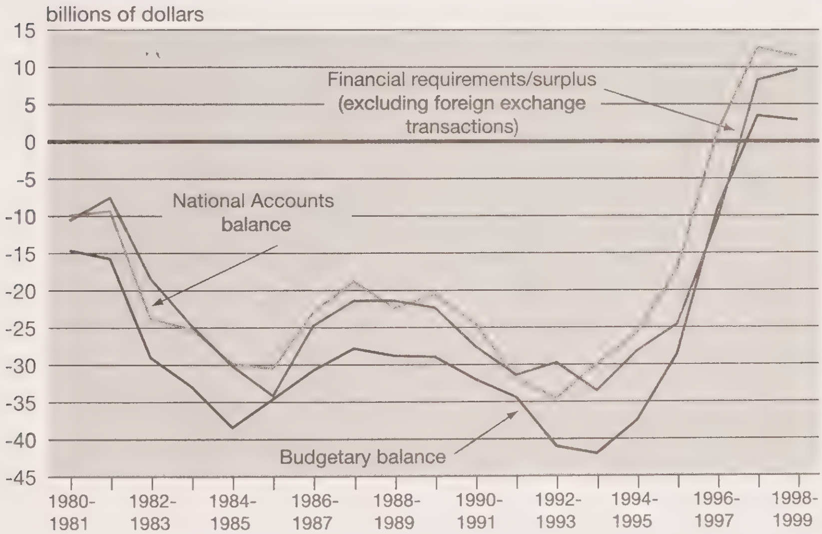


Table A2.1

Alternative Measures of the Federal Budget Balance[1]

Fiscal year	Budgetary balance		Financial requirements/surplus (excluding foreign exchange transactions)		National Accounts balance[2]	
	Millions of dollars	Per cent of GDP	Millions of dollars	Per cent of GDP	Millions of dollars	Per cent of GDP
1980-81	-14,556	-4.6	-9,917	-3.1	-10,631	-3.4
1981-82	-15,674	-4.3	-9,264	-2.6	-7,516	-2.1
1982-83	-29,049	-7.6	-23,819	-6.3	-18,448	-4.9
1983-84	-32,877	-8.0	-25,219	-6.1	-24,664	-6.0
1984-85	-38,437	-8.6	-29,824	-6.6	-30,092	-6.7
1985-86	-34,595	-7.1	-30,510	-6.3	-34,068	-7.0
1986-87	-30,742	-6.0	-22,918	-4.5	-24,721	-4.8
1987-88	-27,794	-5.0	-18,849	-3.4	-21,422	-3.8
1988-89	-28,773	-4.7	-22,424	-3.7	-21,360	-3.5
1989-90	-28,930	-4.4	-20,530	-3.1	-22,266	-3.4
1990-91	-32,000	-4.7	-24,538	-3.6	-27,605	-4.1
1991-92	-34,357	-5.0	-31,800	-4.7	-31,391	-4.6
1992-93	-41,021	-5.9	-34,497	-4.9	-29,709	-4.3
1993-94	-42,012	-5.8	-29,850	-4.1	-33,451	-4.6
1994-95	-37,462	-4.9	-25,842	-3.4	-28,241	-3.7
1995-96	-28,617	-3.5	-17,183	-2.1	-24,649	-3.1
1996-97	-8,897	-1.1	1,265	0.2	-10,535	-1.3
1997-98	3,478	0.4	12,729	1.5	8,347	1.0
1998-99	2,884	0.3	11,491	1.3	9,658	1.1

[1] A positive number denotes a surplus, a negative number denotes a deficit.

[2] National Accounts balance figures are on a calendar-year basis.

As the deficits or surpluses derived from these three measures are different, so are the measures of debt (Table A2.2).

- The accumulation of annual budgetary deficits and surpluses since Confederation is the net public debt.
- For financial requirements/surpluses, the relevant measure is the stock of market debt that the Government has outstanding.
- Another important debt measure in the Public Accounts is interest-bearing debt. This measure includes all interest-bearing liabilities of the Government of Canada and is the most appropriate measure for calculating the average effective interest rate. Interest-bearing debt is larger than market debt because it includes liabilities which have not been issued on markets – notably the Government's liabilities to its employees' pension accounts. Interest-bearing debt is larger than the net debt because it includes the Government's liabilities only, while the net debt is net of financial assets.
- The National Accounts debt represents the Government's total liabilities minus its financial assets.

Table A2.2
Alternative Measures of the Federal Debt

Fiscal year	Net debt		Interest-bearing debt		Market debt		National Accounts debt[1]	
	Millions of dollars	Per cent of GDP	Millions of dollars	Per cent of GDP	Millions of dollars	Per cent of GDP	Millions of dollars	Per cent of GDP
1980-81	91,948	29.2	112,418	35.7	83,138	26.4	49,380	15.7
1981-82	107,622	29.9	126,684	35.1	93,167	25.8	59,359	16.5
1982-83	136,672	36.0	154,221	40.6	116,562	30.7	79,789	21.0
1983-84	169,549	41.2	184,849	45.0	142,901	34.8	109,753	26.7
1984-85	207,986	46.3	219,458	48.8	172,719	38.4	142,565	31.7
1985-86	242,581	50.0	253,381	52.2	201,229	41.5	173,838	35.8
1986-87	273,323	53.4	286,034	55.9	228,611	44.7	200,769	39.2
1987-88	301,117	54.0	313,948	56.3	250,809	44.9	219,013	39.2
1988-89	329,890	53.9	345,057	56.4	276,301	45.2	239,306	39.1
1989-90	358,820	54.7	370,104	56.4	294,562	44.9	266,781	40.7
1990-91	390,820	57.6	406,475	59.9	323,903	47.8	293,756	43.3
1991-92	425,177	62.2	440,181	64.4	351,885	51.5	324,416	47.5
1992-93	466,198	66.7	477,034	68.3	382,741	54.8	363,123	52.0
1993-94	508,210	70.1	514,510	71.0	413,975	57.1	395,539	54.6
1994-95	545,672	71.1	550,192	71.7	440,998	57.5	424,372	55.3
1995-96	574,289	71.2	586,387	72.7	469,547	58.2	455,786	56.5
1996-97	583,186	69.9	600,557	72.0	476,852	57.2	458,817	55.0
1997-98	579,708	66.3	594,825	68.1	467,291	53.5	450,002	51.5
1998-99	576,824	64.4	594,985	66.4	460,427	51.4	433,168	48.4

[1] National Accounts debt figures represent net financial assets on a calendar-year basis.

Annex 3

The Restoration of Fiscal Health in the Federal-Provincial-Territorial Government Sector

Introduction

This annex provides a brief overview of the fiscal performance of the federal, provincial and territorial governments. In assessing fiscal performance, the evolution of budget balances, net debt, debt servicing costs, revenues, program spending and operating balances, on a Public Accounts basis, are all taken into consideration.

Federal-Provincial-Territorial Government Sector in Surplus

Recent years have witnessed a significant restoration of the fiscal health of the federal-provincial-territorial government sector in Canada. This sector's deficit of $66 billion in 1992-93 was completely eliminated by 1998-99. In that year, the federal surplus of $2.9 billion offset the deficit of $1.9 billion at the provincial-territorial level.

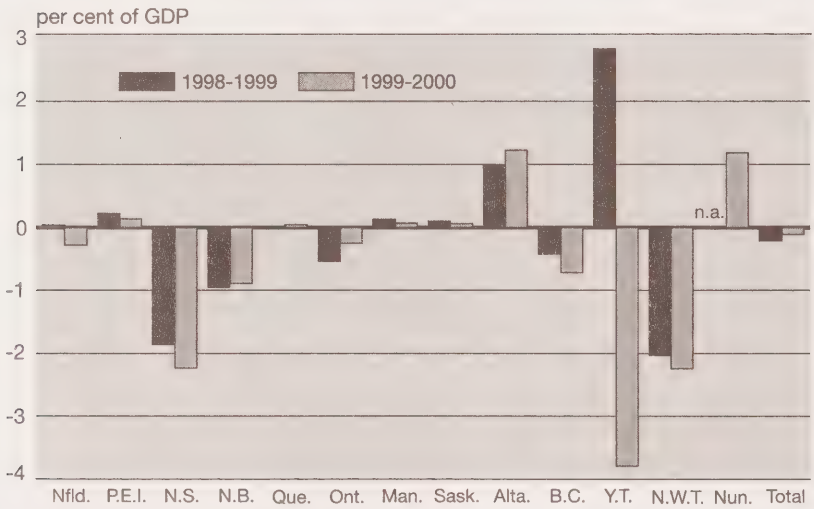
Six provinces and territories are expecting a balanced budget or surplus in 1999-2000, compared to seven in 1998-99 (Chart A3.1). Recent accounting changes in Nova Scotia and New Brunswick have led to a deterioration in their budgetary balances.

Largely because of the better-than-projected results through the first half of 1999-2000 in Ontario and Alberta, fiscal improvement in the overall provincial-territorial sector is expected to continue in 1999-2000. Robust economic growth and high energy prices are leading to significant growth in provincial-territorial revenues.

Chart A3.1

Provincial-Territorial Surpluses (+)/Deficits (-)

(Public Accounts Basis)



Source: Department of Finance, Canada.

As a result of these factors and continued fiscal discipline, the provincial-territorial deficit is expected to fall to $1.1 billion in 1999-2000, the seventh consecutive yearly decline (Chart A3.2). This represents the lowest provincial-territorial deficit in over 20 years.

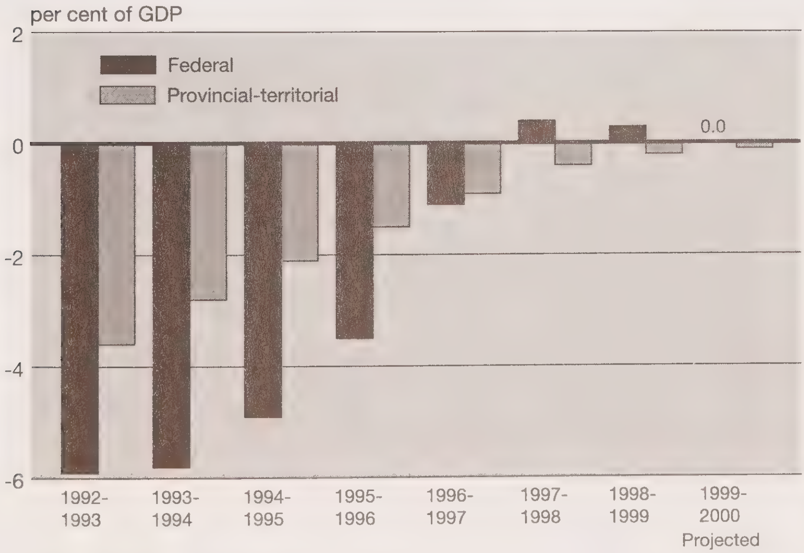
The federal government is committed to a balanced budget or better for 1999-2000. As a result, the federal-provincial-territorial government sector is expected to post at most a small deficit in 1999-2000.

Moreover, based on the latest budget plans, the provincial-territorial deficit should continue to decline in the medium term, as all provinces and territories are committed to balanced budgets. In addition, the federal government remains committed to a balanced budget or better in both 2000-01 and 2001-02. As a result, the federal-provincial-territorial government sector should record balanced budgets or better in each of the next two fiscal years.

Chart A3.2

Federal and Provincial-Territorial Budgetary Surpluses (+)/Deficits (-)

(Public Accounts Basis)



Source: Department of Finance, Canada.

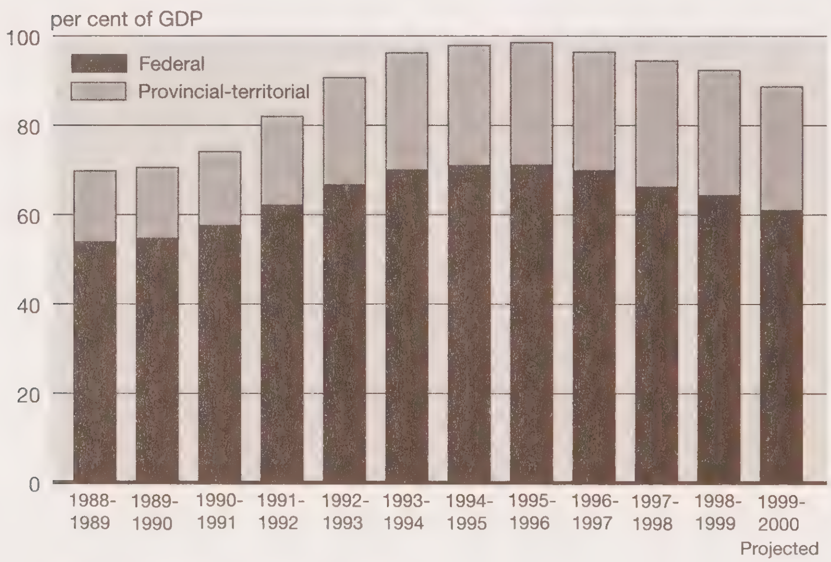
Lower Net Debt Burden

After peaking in 1995-96 at 98.6 per cent of GDP, the federal-provincial-territorial net debt-to-GDP ratio is projected to fall to 88.7 per cent of GDP in 1999-2000 (Chart A3.3). The improvement in overall fiscal balances, coupled with sustained GDP growth, has enabled both the federal and provincial-territorial governments to reduce their debt burdens in recent years.

The federal debt burden is projected to decline to about 61.1 per cent of GDP in 1999-2000 from its peak of 71.2 per cent of GDP in 1995-96. Through the Debt Repayment Plan and continued economic growth, the Government is committed to ensuring that the debt-to-GDP ratio remains on a sustained downward path.

The provincial-territorial debt burden, which has been declining since 1997-98, is estimated at 27.6 per cent of GDP in 1999-2000.

Chart A3.3
Federal and Provincial-Territorial Net Debt
(Public Accounts Basis)



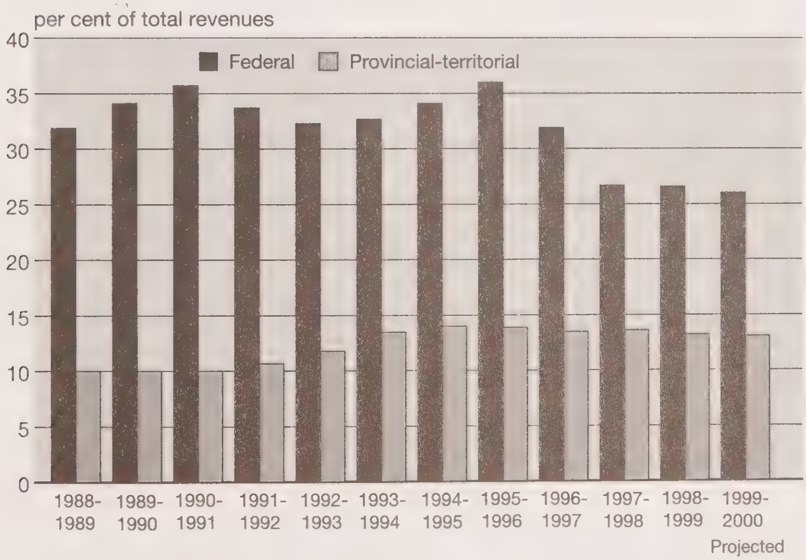
Source: Department of Finance, Canada.

Lower Debt Charges as a Share of Total Revenues

Primarily because of deficit elimination, federal debt charges as a share of total revenues have declined rapidly since 1995-96 and are expected to fall to 26.0 per cent of revenues in 1999-2000 from a peak of 36.0 per cent in 1995-96. In contrast, given a much lower debt burden, provincial-territorial debt charges as a share of total revenues have declined only marginally since 1995-96 and are expected to fall to 13.1 per cent of revenues in 1999-2000 from a peak of 13.9 per cent in 1995-96 (Chart A3.4).

Chart A3.4

Federal and Provincial-Territorial Debt Charges
(Public Accounts Basis)



Source: Department of Finance, Canada.

Stable Revenues Relative to the Size of the Economy

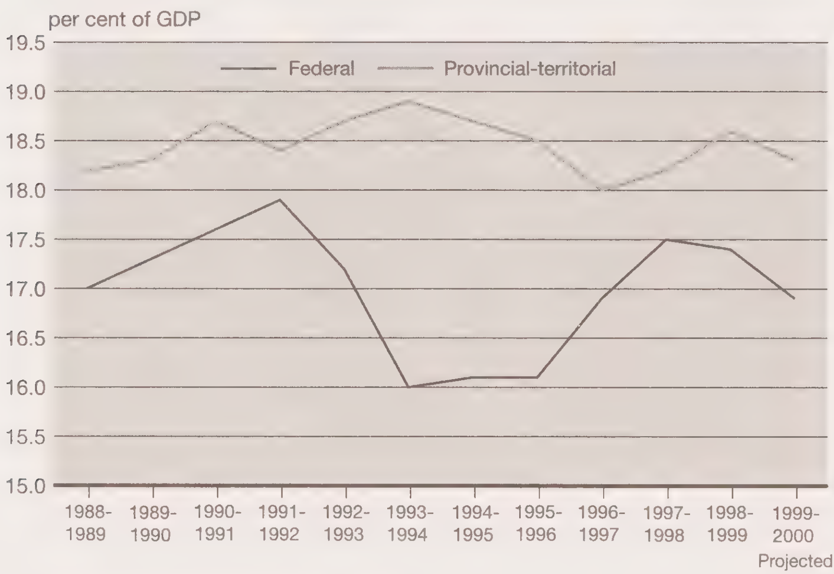
Although total revenues for both levels of government continue to grow, they currently represent a similar share of GDP to what they were at the end of the 1980s (Chart A3.5).

Federal revenues as a share of GDP dropped significantly following the 1990-1991 recession. However, with the ensuing growth of the economy and a progressive tax system, federal revenues rose steadily until 1997-98. Since 1997-98, this ratio has begun to decline again – this time as a result of the tax reduction measures implemented in the 1998 and 1999 budgets.

Provincial-territorial revenues, however, have remained more stable over the last 10 years. In 1999-2000, they are expected to decline slightly as a share of GDP, reflecting recent provincial tax cuts.

Chart A3.5

Federal and Provincial-Territorial Total Revenues
(Public Accounts Basis)



Source: Department of Finance, Canada.

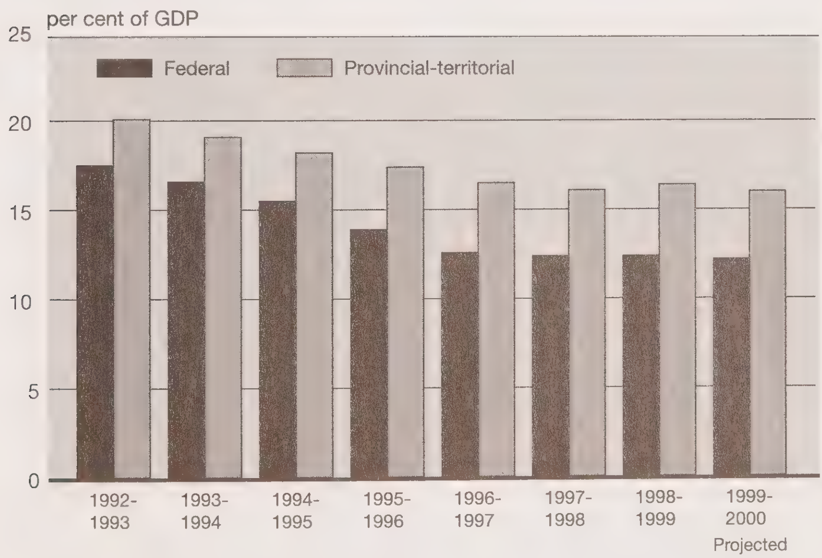
Declining Program Spending as a Share of GDP

Program spending as a percentage of GDP for both levels of government will continue its downward trend in 1999-2000, reflecting robust economic growth and continued fiscal discipline (Chart A3.6).

Federal program spending is expected to fall to 12.2 per cent of GDP in 1999-2000, the lowest level since 1949-50. This represents a 5.3-percentage-point drop from its peak in 1992-93. Likewise, provincial-territorial program spending is expected to decline to 16.0 per cent of GDP in 1999-2000, down from 20.1 per cent in 1992-93.

Chart A3.6

Federal and Provincial-Territorial Program Spending
(Public Accounts Basis)



Source: Department of Finance, Canada.

Growing Operating Surpluses

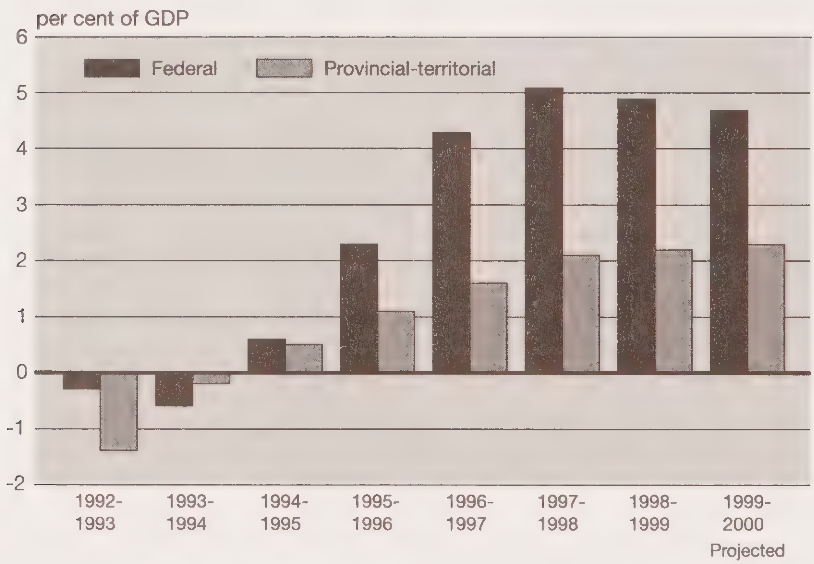
Fiscal consolidation strategies pushed operating balances, defined as the difference between total budgetary revenues and program spending, from a deficit in 1993-94 to a significant surplus by 1998-99.

The federal government, which recorded an operating deficit of 0.3 per cent of GDP in 1992-93, is expected to record an operating surplus of 4.7 per cent of GDP in 1999-2000. The provincial-territorial sector, which recorded an operating deficit of 1.4 per cent of GDP in 1992-93, is expected to record an operating surplus of 2.3 per cent of GDP in 1999-2000 (Chart A3.7).

The trends shown in Charts A3.5 and A3.6 indicate that the federal and provincial-territorial governments achieved their operating balance improvements primarily through expenditure cuts.

Chart A3.7

Federal and Provincial-Territorial Operating Balances
(Public Accounts Basis)



Source: Department of Finance, Canada.

Annex 4

Canada's Financial Progress in an International Context

Introduction and Overview

This annex compares Canada's improving financial position with that of the other Group of Seven (G-7) countries (United States, United Kingdom, France, Germany, Japan and Italy).

Two factors tend to complicate international financial comparisons. First, differences in accounting methods among countries affect the comparability of the data. Second, financial responsibilities are distributed differently among the various levels of government in each country. For these reasons, the standardized System of National Accounts definitions and data, which are fairly uniform across countries, are used for the government sector when making fiscal comparisons. The Organisation for Economic Co-operation and Development (OECD) produces a complete series of estimates based on this system. The data presented here are based on the OECD's December 1999 forecasts and, as such, do not include any data revisions since then.

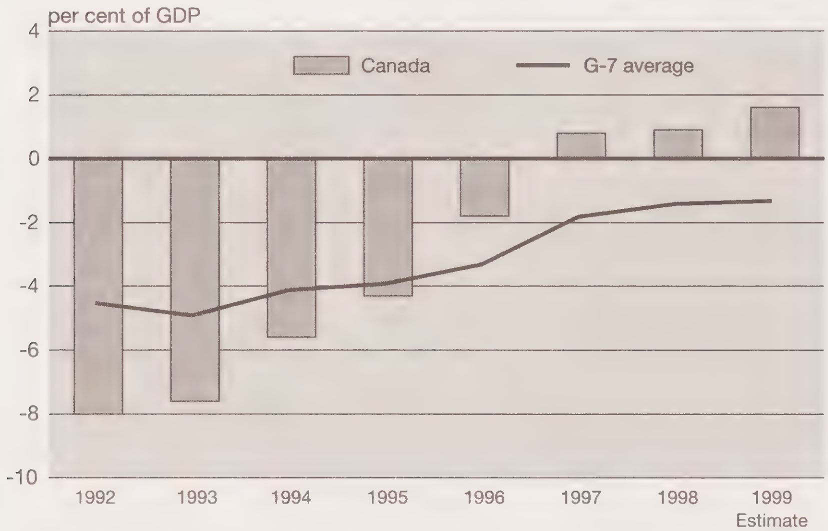
Significant Budget Surpluses for Canada

Following the recession of the early 1990s, the total Canadian government sector[1] deficit peaked at 8 per cent of gross domestic product (GDP) in 1992, compared to the G-7 average deficit-to-GDP ratio of 4.5 per cent that same year.

Subsequent deficit reduction efforts by all levels of Canadian government resulted in a total government budget surplus in 1997. This has since been maintained. The OECD estimates that Canada's budget surplus will reach 1.6 per cent of GDP in 1999, compared to an average deficit of 1.3 per cent of GDP in the G-7 countries (Chart A4.1).

Chart A4.1

Total Government Deficit (-)/Surplus (+): Canada vs. G-7 Average (National Accounts Basis)



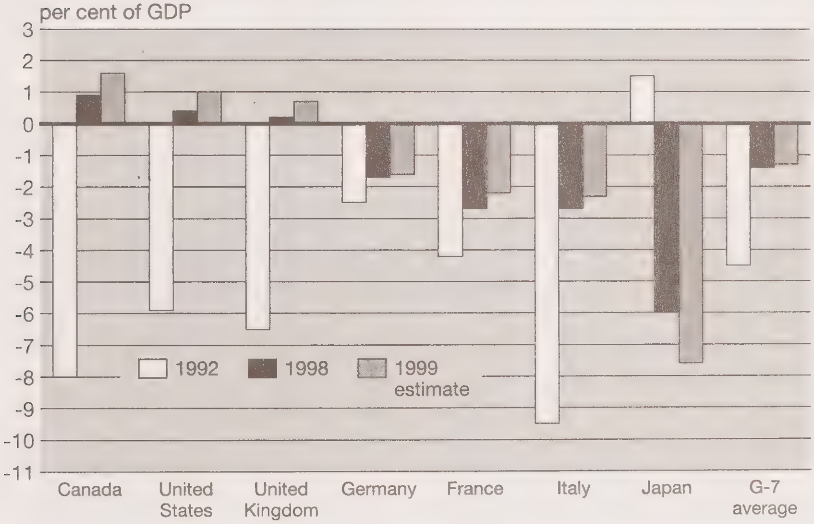
Source: *OECD Economic Outlook,* December 1999.

[1] Includes federal, provincial and local governments as well as the balances in the Canada Pension Plan and Quebec Pension Plan.

Canada's budgetary improvement over the 1992-1999 period surpassed that of all other G-7 countries. Over this period, Canada recorded a turnaround of nearly 10 percentage points (Chart A4.2). The only other G-7 countries expected to post a surplus in 1999 are the United States and the United Kingdom.

Chart A4.2

Total Government Deficit (-)/Surplus (+) in G-7 Countries
(National Accounts Basis)



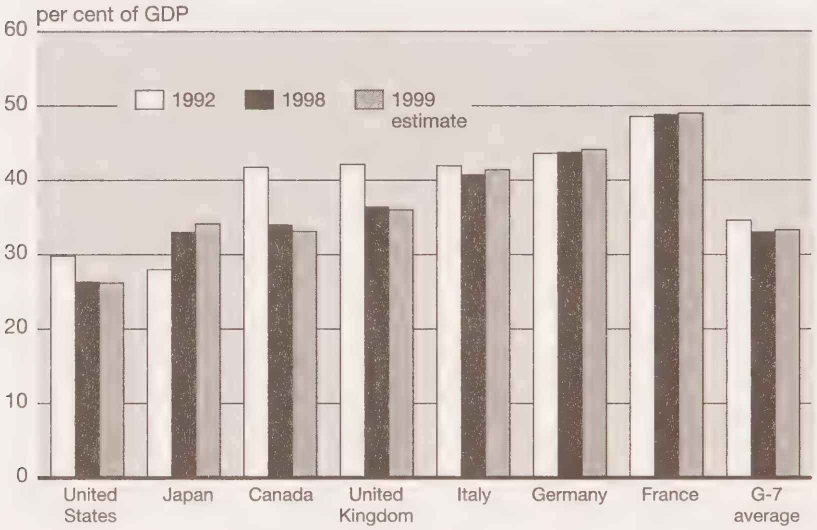
Source: *OECD Economic Outlook*, December 1999.

A Faster Decline in Program Spending

Sharp cuts in program spending have enabled Canada to quickly put its fiscal house in order. In 1992, Canada's program spending as a share of GDP was well above the G-7 average (Chart A4.3). Between 1992 and 1999, Canada implemented the largest reduction in program spending relative to GDP of any G-7 country: program spending as a percentage of GDP dropped about 8.5 percentage points, compared to an average of about 1.5 points for the G-7 countries. In relation to the size of the economy, Canada's program spending is now on a par with the G-7 average.

Chart A4.3

Total Government Program Spending in G-7 Countries
(National Accounts Basis)



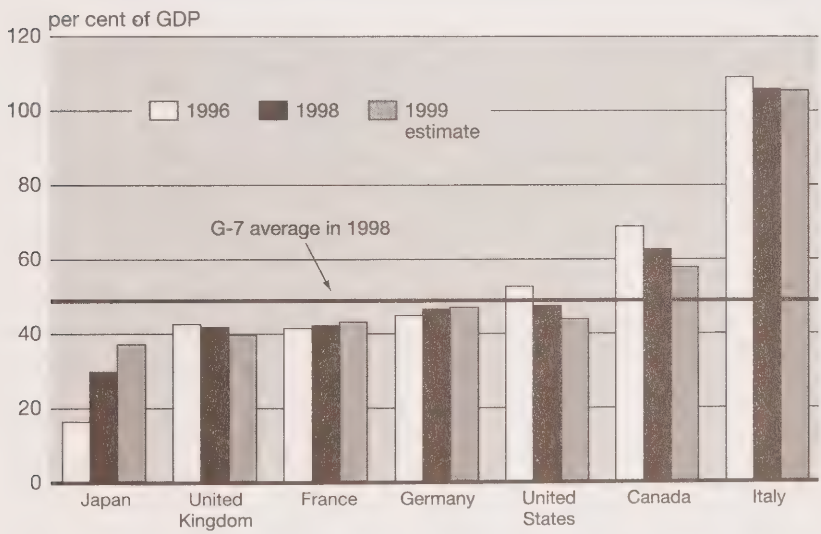
Source: *OECD Economic Outlook,* December 1999.

Sharp Decline in Canada's Net Debt-to-GDP Ratio

Over the past few years, Canada has experienced the sharpest decline in the debt-to-GDP ratio of the G-7 countries. However, despite this recent progress, Canada's debt burden remains high in an international context. In 1999, Canada's debt-to-GDP ratio was about 10 percentage points above the G-7 average (Chart A4.4). A further reduction in the debt burden remains a key objective of Canadian governments' fiscal policy.

Chart A4.4

Total Government Net Debt in G-7 Countries
(National Accounts Basis)



Source: *OECD Economic Outlook*, December 1999.

Annex 5

Fiscal Outlook: Sensitivity to Economic Assumptions

Sensitivity to Changes in Economic Assumptions

Estimates of the main fiscal aggregates are sensitive to changes in economic assumptions – particularly to the level of nominal gross domestic product (GDP) and interest rates. The following sensitivity estimates capture the direct fiscal impacts of changes in these variables. These are static calculations that capture the impact of the changes one economic variable at a time. For example, in the nominal income sensitivity estimate, there is no feed-through of the change in nominal income to other variables, such as interest rates.

In addition, the sensitivity estimates assume that changes in economic assumptions do not affect the Government's balanced budget targets. Positive economic developments are assumed to translate into greater policy action in future budgets. Negative economic developments are assumed to be accommodated by the prudence set aside in the budget. As a result, the estimates do not allow, for example, for second order effects of changes in nominal income on the level of debt and, therefore, debt charges.

Sensitivity to Changes in Nominal Income

A 1-per-cent increase in the level of nominal GDP leads to higher tax bases and thus higher revenues. The ultimate budgetary impact would depend on the source of the increase in nominal income. The most favourable impact on the fiscal situation would occur

if all of the increase in nominal GDP resulted from increased real output. Revenues would be higher while interest rates would be relatively stable.

If, however, the improvement in nominal GDP were solely due to inflation, then higher spending on those programs indexed to inflation would offset some of the positive impact on government revenues. Moreover, with the indexation of the personal income tax system announced in this budget, the revenue gain from an increase in inflation is now less than the gain from an increase in real output.

Assuming the 1-per-cent increase in nominal income comes solely from an increase in real output, the budgetary balance would improve by $2.1 billion in the first year, rising to $2.4 billion after four years (Table A5.1). Revenues would increase $1.6 billion in the first year, rising to $1.8 billion by the fourth year. Expenditures would decline $0.5 billion, almost entirely due to the reduction in employment insurance (EI) benefits that would follow from the reduction in the level of unemployment normally associated with an increase in output.

Table A5.1
Fiscal Sensitivity Analysis: 1-Per-Cent Increase in Nominal Income

	Estimated changes in fiscal position			
	Year 1	Year 2	Year 3	Year 4
	(billions of dollars)			
Budgetary transactions				
Revenue increase	1.6	1.7	1.8	1.8
Expenditure reduction	0.5	0.5	0.5	0.5
Improvement in budgetary balance	2.1	2.2	2.3	2.4

Note: Numbers may not add due to rounding.

These estimates are higher than those presented in the 1999 budget. This is because the sensitivity estimate described above captures the effect of changes in output on the EI program, while the estimates included in the 1999 budget did not. As noted in the 1999 budget, the EI program increases the sensitivity of the budget balance to changes in real output by close to $650 million in the first year of the shock. This consists of just under $150 million in higher EI revenues and just under $500 million in lower EI benefits.

Sensitivity to Changes in Interest Rates

Changes in market interest rates, all other things remaining equal, result in changes in public debt charges and revenues from interest-bearing assets. The ultimate budgetary impact will depend on the magnitude of the change in market rates, the size and composition of the debt stock and the amount of interest-bearing assets.

A sustained 100-basis-point decline in all interest rates would cause the budget to improve by $900 million in the first year, rising to $2.2 billion in the fourth year (Table A5.2). Expenditures (public debt charges) would fall $1.2 billion in the first year. As longer-term debt matures and is refinanced at the lower interest rates, the positive impact on public debt charges would increase, reaching $2.7 billion by year four. However, the positive impact on public debt charges due to the decline in market interest rates would be somewhat offset by a reduction in interest earnings on the Government's interest-bearing assets (which are accounted for in non-tax revenue). These assets largely consist of assets in the Exchange Fund Account, Bank of Canada assets and the Government's cash balances, which are invested in short-term securities.

Table A5.2
Fiscal Sensitivity Analysis: 100-Basis-Point Decrease in Interest Rates

	Estimated changes in fiscal position			
	Year 1	Year 2	Year 3	Year 4
	(billions of dollars)			
Budgetary transactions				
Revenue reduction	0.3	0.4	0.4	0.5
Expenditure reduction	1.2	1.9	2.4	2.7
Improvement in budget balance	0.9	1.5	2.0	2.2

Note: Numbers may not add due to rounding.

Annex 6

The Government's Response to the Auditor General's Observations on the 1999 Financial Statements

In the 1999 Public Accounts of Canada, the Auditor General expressed a clean opinion on the Government's financial statements for 1998-99. This marks the sixth time in the last eight years he has endorsed the Government's financial statements.

However, as in previous years, the Auditor General raised a number of issues which, in his opinion, are "matters requiring continuing attention." These are:

- the $3.5-billion supplement to the Canada Health and Social Transfer;
- the Financial Information Strategy: the move to full accrual accounting;
- netting (the offsetting of certain expenditures against revenues);
- timely financial statements;
- the Debt Servicing and Reduction Account; and
- the Annual Financial Report of the Government of Canada.

The Government's responses to the Auditor General's observations on the 1999 financial statements are discussed in detail in this annex.

Canada Health and Social Transfer Supplement

In the 1999 budget, the federal government announced a Canada Health and Social Transfer (CHST) cash supplement of $3.5 billion and booked the liability in 1998-99. The Auditor General explains in his report why he accepted the booking of this liability but not the bookings of the liabilities related to the Canada Foundation for Innovation (CFI) in 1996-97 and the Canada Millennium Scholarship Foundation in 1997-98.

The Government recognizes that the booking of the liabilities for the CFI and the Canada Millennium Scholarship Foundation is an area where existing accounting standards do not offer explicit guidance and that professional judgment must be brought to bear. The Government has consistently argued that its decisions to provide funding to arm's-length organizations, such as the CFI and the Canada Millennium Scholarship Foundation, established liabilities that should be recorded in the year that the decisions to provide funding were made. The Government consulted two major accounting firms, both of which endorsed the Government's approach.

This treatment enhances transparency and accountability to Parliament and Canadians. The Government has been consistent in this practice and will continue to apply it in the future. As such, in accordance with its stated accounting policy, non-recurring liabilities will be recognized in the year the decision to incur them is made, provided the enabling legislation or authorization for payment receives parliamentary approval before the financial statements for that year are finalized.

Further, the Auditor General reports that during the course of the past year he undertook research on the accounting treatment of such "special purpose entities" to determine if they should be consolidated in the Government's financial statements as part of the Government's overall reporting entity. From his research, he concludes that the application of current PSAB (Canadian Institute of Chartered Accountants' Public Sector Accounting Board) accounting recommendations requires considerable judgment to determine the appropriate accounting treatment. He "strongly recommends that the Government encourage PSAB to provide additional guidance in the form of either an Accounting Guideline or a change in the PSAB Handbook."[1]

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[1] *Public Accounts of Canada 1999. Volume I: Summary Report and Financial Statements*, p. 1.35.

Both the CFI and the Canada Millennium Scholarship Foundation were established as arm's-length organizations for sound public policy reasons. As arm's-length organizations, these foundations operate outside the influence of political considerations and can attract funding from the private sector to pursue their objectives. The Government is committed to ensuring that these foundations operate without government interference. The Government continues to believe that, in its application of PSAB recommendations, these entities should not be considered part of government and therefore should not be consolidated within its financial statements.

The Financial Information Strategy: The Move to Full Accrual Accounting

Currently, the Government records most of its expenditures and non-tax revenues on an accrual basis of accounting. In contrast, tax revenues and capital assets are recorded on a cash basis of accounting. In previous budgets, the Government has indicated its intention to move to full accrual accounting and the Auditor General has supported this move. Although he has once again expressed concern that the Government may not be in a position to implement this in a timely fashion, he acknowledges that "the Government has made progress toward its objective."[2]

The specific areas where the Auditor General comments on progress being made include Aboriginal claims, environmental liabilities, accrual of tax revenues, enterprise Crown corporations, capital assets, prepaid expenses and inventories. Although fully supportive of the Government's goal and strategy to implement all of these accounting policy changes in 2001-02, he believes that it is ambitious and that considerable work remains to be done.

The Government recognizes the implementation of the Financial Information Strategy (FIS) and "full" accrual accounting as a priority and recently provided additional support to departments in this area. It will continue to work closely with the Office of the Auditor General to ensure the successful implementation of the FIS and full accrual accounting in 2001-02.

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[2] *Public Accounts of Canada 1999. Volume I: Summary Report and Financial Statements*, p. 1.35.

Netting: the Offsetting of Expenditures Against Revenues

The Auditor General points out that the Government currently reports revenues and expenditures on a net basis. For budgetary purposes, there are a number of tax expenditures that are netted against revenues and a number of revenue items that are netted against spending. Netted against revenues are the Canada Child Tax Benefit (CCTB), the quarterly goods and services tax (GST) credit and repayments of Old Age Security benefits. Netted against spending are revenues of consolidated Crown corporations and revenues from levies charged by departments for specific services, such as the costs of policing services in provinces. This netting has no impact on the overall budgetary balance.

The Auditor General has recommended that the financial statements and the budget be prepared only on a gross basis. Of particular concern to the Auditor General is the CCTB, which is currently netted against personal income tax revenues. The Auditor General argues that this represents "incomplete financial disclosure."[3]

In fact, the Government already publishes this information each year in the fall. Both the *Annual Financial Report of the Government of Canada* and the Public Accounts, which contain the audited financial results of the Government, report revenues and expenditures on both a "gross" and "net" basis.

The "net" presentation is the appropriate approach for the budget because it is consistent with the way that Parliament appropriates funds. Furthermore, programs like the CCTB and the quarterly GST credit are integral parts of the tax system. These programs are administered through the tax system. They are thus netted from tax revenues for budgetary purposes.

Timely Financial Statements

The Auditor General has questioned the amount of time it takes for the Government to prepare the year-end financial statements. Moreover, he argued that a number of departments do not consider themselves accountable for the Public Accounts in the preparation of these statements.

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[3] *Public Accounts of Canada 1999. Volume I: Summary Report and Financial Statements*, p. 1.37.

The 1999 Public Accounts were finalized within six months of the end of the 1998-99 fiscal year, almost a month earlier than the previous year. Timely financial reporting is a priority and the Government will ensure that adherence to reporting deadlines is monitored, enforced and improved where feasible.

The Debt Servicing and Reduction Account

The Debt Servicing and Reduction Account (DSRA) was established by statute in June 1992. Under that legislation, all GST revenues, net of applicable input tax credits, rebates and the low-income credit, along with the net proceeds from the sale of Crown corporations and gifts to the Crown explicitly identified for debt reduction, must be deposited into this Account. The funds in this Account are earmarked to pay interest on the public debt and, ultimately, to reduce the debt. In 1998-99, net revenues, primarily from the GST, amounted to $20.8 billion. In contrast, public debt expenditures chargeable to the Account were $30.8 billion.

In his 1996-97 observations, the Auditor General recommended that the Government re-examine the need for and usefulness of the DSRA. He raised this issue in his opening statement to the House of Commons Standing Committee on Finance in July 1998 and again in his observations on the 1998-99 financial statements.

In his 1996-97 observations, the Auditor General noted that "given the fundamental concept of the Consolidated Revenue Fund (CRF) underlying the Government's accounting system, the Account is an internal mechanism that may not be necessary." All revenues received by the Government must be deposited in the CRF and any disbursements from it must be authorized by Parliament. Therefore, the specific revenues of the DSRA must be deposited in the CRF and the public debt expenditures chargeable to the Account must be appropriated from it by Parliament. Since all of the information relating to the DSRA is already reported in other parts of the Government's financial statements, there appears to be limited usefulness in having a separate financial statement.

The House of Commons Standing Committee on Finance's recommendations for the 2000 budget included elimination of the DSRA.

Although all of the information relating to the DSRA is already reported in other parts of the Government's financial statements, as noted by the Auditor General, the Government believes that, at this time, the DSRA provides important information to Canadians on the flow of GST revenues, gifts to the Crown and the net gains associated with the disposals of investments in Crown corporations. This information is enhanced through the presentation of a separate audited statement. As a result, the Government does not propose any changes be made at this time.

The Annual Financial Report of the Government of Canada

The Auditor General approved of the changes made to the 1998-99 *Annual Financial Report of the Government of Canada* (AFR). In particular, he endorsed the inclusion of a user survey in the 1998-99 AFR and encouraged the Government to use the results of the user survey to continually improve the document.

The AFR is available both in printed format and on the Department of Finance Canada Internet site. A total of 2,460 printed copies of the AFR for 1998-99 have been circulated with a roughly comparable number of "hits" on the Internet site. In total, there were 51 responses to the questionnaire. Although the survey was not scientific, some of the relevant results are summarized below.

Results regarding the content and organization of the AFR were generally very positive. About one-half of those who completed the survey said that they were "somewhat satisfied," while about 30 per cent said that they were "very satisfied" with both organization and content.

The results also show that the majority of respondents felt that the AFR contained a sufficient amount of information.

Selected Questions

How satisfied are you with the current content of the Annual Financial Report?

Response	Number of esponses	% of respondents
Very satisfied	17	33.3
Somewhat satisfied	24	47.1
Somewhat dissatisfied	3	5.9
Very dissatisfied	0	0.0
Don't know	7	13.7
Total	51	100.0

How satisfied are you with the organization of the information in the Annual Financial Report?

Response	Number of responses	% of respondents
Very satisfied	15	29.4
Somewhat satisfied	27	52.9
Somewhat dissatisfied	3	5.9
Very dissatisfied	1	2.0
Don't know	5	9.8
Total	51	100.0

Is the information in the Annual Financial Report presented in:

Response	Number of responses	% of respondents
Enough detail	36	73.5
Not enough detail	10	20.4
Too much detail	3	6.1
Total	49	100.0

Annex 7

Tax Measures: Supplementary Information and Notices of Ways and Means Motions

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Tax Measures: Supplementary Information

Overview

The budget provides a Five-Year Tax Reduction Plan. The Plan improves four areas of the tax system. It eliminates automatic increases in the tax burden due to bracket creep and eroding real benefits; it reduces the high tax burden at the middle-income level; it increases support for families with children; and it makes the Canadian economy more internationally competitive.

Table A7.1 summarizes those measures of the Plan that will be legislated pursuant to the 2000 budget and provides estimates of the amount of tax relief they will provide.

Table A7.2 provides a complete listing of additional specific measures and provides estimates of their impacts on federal tax revenues. A more comprehensive list of these measures and those announced in the six previous budgets is provided in the appendix to this annex.

Tables A7.3 to A7.6 provide estimates of personal income tax relief resulting from both the Plan and the 1997, 1998 and 1999 budgets. They include information on tax cuts for all taxpayers, families with children and low- and middle-income Canadians. The Plan will reduce total personal income tax by 15 per cent on an annual basis by 2004-05. When combined with tax measures in the 1997, 1998 and 1999 budgets, tax reductions average 22 per cent.

Tables A7.7 to A7.9 provide information on the extent of tax relief for typical Canadians as a result of measures in the Plan legislated pursuant to the 2000 budget. Tables A7.10 to A7.15 are more comprehensive as they show the impact of the entire Plan in combination with the tax relief actions taken in the 1997, 1998 and 1999 budgets.

The Plan will reduce taxes by a cumulative amount of at least $58 billion over the next five years. The estimate of tax relief is based on actions to be legislated pursuant to the budget and presumes all other personal and corporate tax actions are taken only in the final year of the Plan. To the degree these remaining actions are taken sooner – or the tax reductions exceed those set out in the Plan – the cumulative tax relief would exceed $58 billion.

Table A7.1
Federal Revenue Impact of Legislated Measures: General Tax Relief

	2000-01	2001-02	2002-03
	(millions of dollars)		
Eliminate Automatic Increases in the Tax Burden Due to Inflation			
Restore full indexation to the tax system effective January 1, 2000		See below	
Indexation of income amounts Canadians can earn tax-free[1]	-420	-730	-1,145
Reduce the High Tax Burden at the Middle-Income Level			
Reduce the 26-per-cent tax rate to 24 per cent effective July 1, 2000	-1,520	-2,145	-2,265
Increase the income level at which the middle tax rate begins to apply[1]	-380	-675	-1,060
Increase the income level at which the top tax rate begins to apply[1]	-55	-105	-165
Eliminate the 5-per-cent surtax for basic federal tax up to $18,500 (about $85,000 in income) effective July 1, 2000, and reduce the surtax rate from 5 per cent to 4 per cent effective January 1, 2001	-185	-305	-330
Increase Support for Children			
Canada Child Tax Benefit (CCTB) improvements[1]	-475	-1,020	-1,350
Make the Canadian Economy More Internationally Competitive			
Reduce the federal corporate income tax rate to 27 per cent from 28 per cent on business income not currently eligible for special tax treatment effective January 1, 2001	-60	-375	-425
Reduce the federal corporate income tax rate to 21 per cent, effective January 1, 2001, on active business income between $200,000 and $300,000 earned by a small business	-20	-90	-95
Reduce the capital gains inclusion rate from three quarters to two thirds	-15	-135	-230
Postpone taxation of gains on qualifying stock options to when shares are sold rather than when options are exercised	-10	-75	-75
Allow tax-free rollover of capital gains on qualified investments from one small business to another	-20	-75	-75
Other indexation[1]	-195	-300	-470
Total	**-3,355**	**-6,030**	**-7,685**
Of which indexation contributes	**-1,270**	**-2,185**	**-3,450**

[1] Amounts include indexation, based on an assumed average annual inflation rate of 1.8 per cent.

Table A7.2
Federal Revenue Impact of Measures: Other

	2000-01	2001-02	2002-03
	(millions of dollars)		
Personal Income Tax			
Federal surtax for deemed residents	-5	-5	-5
Foreign property rules	–	–	–
Persons with disabilities	-15	-45	-45
Personal-use property	–	–	–
Charitable donations: designations in favour of charity	–	–	–
Ecologically sensitive land	-5	-5	-5
Interest offset	–	–	–
Charitable donations of shares acquired with employee stock options	-10	-10	–
Partial exemption for scholarships, fellowships and bursaries	-5	-30	-30
Corporate Tax Measures			
Strengthening thin capitalization rules	–	50	60
Non-resident-owned investment corporations	–	–	5
Weak-currency borrowings	–	–	–
Government assistance for scientific research and experimental development (SR&ED)	60	60	60
Foreign tax credit and oil and gas production sharing agreements	–	–	–
Manufacturing and processing tax rate reduction extended to income from sale of steam	–	–	–
Adjustments to capital cost allowance regime	-10	-45	-80
Capital tax surcharge on large deposit-taking institutions	30	50	–
Tobacco surtax[1]	70	70	70
Goods and Services Tax/Harmonized Sales Tax			
Distribution Centres	–	–	–
New Residential Rental Property Rebate	-15	-40	-45
Jeopardy assessment and collection	–	–	–
Other Measures			
SR&ED tax credit for internal use software development	–	–	–
Simplified film tax incentive	–	–	–
Heritage buildings	–	–	–
First Nations taxation	–	–	–
Release of information	–	–	–
Administration and enforcement of the tax law	–	–	–
Sharing of tax information with provincial statistical agencies	–	–	–
Changes to Countervailing Duty Law	–	–	–
Tobacco export tax exemption	–	–	–
Tobacco tax increase[1]	70	70	70
Total	**165**	**120**	**55**

– Small, non-existent or prevents revenue loss.

[1] Measures announced prior to the budget.

Table A7.3
Amount of Personal Income Tax Relief in 2004-05: 1997-1999 Budgets and the Five-Year Tax Reduction Plan

	Total	Families with children[1]	Low-/ middle-income[2]
	(millions of dollars)		
Total 1997-1999 Budget Measures	**8,380**	**4,325**	**7,095**
The Five-Year Tax Reduction Plan			
Increase the amount Canadians can earn tax-free to $8,000 and $6,800 (spousal)	2,760	960	2,630
Reduce the middle rate to 23 per cent	3,600	1,380	2,935
Increase middle and upper tax brackets to $35,000 and $70,000 respectively	3,670	1,420	3,050
Eliminate 5-per-cent surtax	865	370	80
Enhance Canada Child Tax Benefit	2,525	2,525	2,445
Reduce capital gain inclusion rate to two thirds[3]	210	55	70
Stock options	75	25	5
Rollover of capital gains	75	25	5
Other, including indexation of remaining parameters	920	210	895
Total	**14,700**	**6,970**	**12,115**
Total (1997-99 and the Plan)	**23,080**	**11,295**	**19,210**

[1] Calculated based on the proportion of federal personal income tax relief that would accrue to families with children.

[2] Calculated based on the proportion of federal personal income tax relief that would accrue to low- and middle-income individuals and families with income of $85,000 or less.

[3] Amount of personal income tax relief only – does not include portion that would accrue to corporations.

Table A7.4
Amount of Annual Personal Income Tax Relief: All Taxpayers, 2004-05

	Five-Year Tax Reduction Plan	All budgets: 1997 – 2004
Total net personal income tax reduction (billions of dollars)[1]	14.7	23.1
Net personal income tax revenues before tax reduction (billions of dollars)[2]	97.5	105.8
Per cent reduction in personal income tax	15.1	21.8

[1] Total tax reduction as calculated in Table A7.3.

[2] Personal income tax revenues in 2001-02 as presented in Chapter 3 of *The Budget Plan 2000*, grown to 2004-05 based on the growth rate of revenues in the 1999 *Economic and Fiscal Update*. Relative to aggregate federal personal income taxes estimated to be paid to the Government in fiscal year 2004-05, net of refundable credits (CCTB and the goods and services tax credit). These credits are estimated at $9.4 billion by 2004-05.

Table A7.5
Amount of Annual Personal Income Tax Relief: Families With Children, 2004-05

	Five-Year Tax Reduction Plan	All budgets: 1997 – 2004
Total net personal income tax reduction (billions of dollars)[1]	7.0	11.3
Net personal income tax revenues before tax reduction (billions of dollars)[2]	32.9	37.3
Per cent reduction in personal income tax	21.3	30.3

[1] Based on average share of all personal income tax reduction measures attributable to families with children. Full calculation in Table A7.3.

[2] Relative to aggregate federal personal income taxes estimated to be paid by families with children to the Government in fiscal year 2004-05, net of refundable credits (CCTB and the goods and services tax credit). These credits are estimated at $7.5 billion by 2004-05 for families with children.

Table A7.6
Amount of Annual Personal Income Tax Relief: Low- and Middle-Income Canadians, 2004-05

	Five-Year Tax Reduction Plan	All budgets: 1997 – 2004
Total net personal income tax reduction (billions of dollars)[1]	12.1	19.2
Net personal income tax revenues before tax reduction (billions of dollars)[2]	65.8	73.1
Per cent reduction in personal income tax	18.4	26.3

[1] Based on average share of all personal income tax reduction measures attributable to low- and middle-income Canadians with income of $85,000 or less. Full calculation in Table A7.3.

[2] Relative to aggregate federal personal income taxes estimated to be paid by low- and middle-income Canadians to the Government in fiscal year 2004-05, net of refundable credits (CCTB and the goods and services tax credit). These credits are estimated at $9.4 billion by 2004-05 for low- and middle-income Canadians.

2000 Budget – Impact on Typical Taxpayers

Table A7.7

Typical One-Earner Family of Four – 2000 Budget Annual Impacts

		Proposed 2000 budget			
Total income	Federal tax pre-2000 budget	Total relief (2001)[1]	Total relief as a % of federal tax[2]	Total relief (2004)	Total relief as a % of federal tax
$	$	$	$/%	$	$/%
15,000	-4,398	**-679**	**-679**	**-1,069**	**-1,069**
20,000	-3,601	**-679**	**-679**	**-1,098**	**-1,098**
25,000	-2,000	**-681**	**-681**	**-1,385**	**-1,385**
30,000	-37	**-506**	**-506**	**-1,285**	**-1,285**
35,000	1,710	-543	-31.8	-1,124	-65.8
40,000	3,367	-582	-17.3	-1,128	-33.5
50,000	6,467	-782	-12.1	-1,253	-19.4
60,000	9,592	-1,007	-10.5	-1,477	-15.4
75,000	14,783	-1,152	-7.8	-1,794	-12.1
100,000	22,396	-1,194	-5.3	-1,631	-7.3
125,000	30,008	-1,266	-4.2	-1,703	-5.7

[1] Negative values indicate a reduction in net tax paid to the federal government or an increase in federal refundable credits (Canada Child Tax Benefit, goods and services tax credit).

[2] Where individuals and families receive more in federal refundable credits than they pay in federal income tax, the federal income tax reductions are indicated in bold and represent an increase in net federal benefits they receive. Percentages are not meaningful so the dollar amounts are repeated.

Table A7.8

Typical Two-Earner Family of Four – 2000 Budget Annual Impacts

		Proposed 2000 budget			
Total income	Federal tax pre-2000 budget	Total relief (2001)[1]	Total relief as a % of federal tax[2]	Total relief (2004)	Total relief as a % of federal tax
$	$	$	$/%	$	$/%
15,000	-4,571	**-607**	**-607**	**-896**	**-896**
20,000	-4,503	**-675**	**-675**	**-964**	**-964**
25,000	-3,650	**-675**	**-675**	**-1,088**	**-1,088**
30,000	-2,366	**-735**	**-735**	**-1,433**	**-1,433**
35,000	-576	**-547**	**-547**	**-1,255**	**-1,255**
40,000	820	-367	-44.8	-827	-100.9
50,000	3,179	-343	-10.8	-692	-21.8
60,000	5,811	-501	-8.6	-970	-16.7
75,000	9,822	-681	-6.9	-1,150	-11.7
100,000	15,794	-923	-5.8	-1,302	-8.2
125,000	22,904	-1,337	-5.8	-1,888	-8.2

[1] Negative values indicate a reduction in net tax paid to the federal government or an increase in federal refundable credits (Canada Child Tax Benefit, goods and services tax credit).

[2] Where individuals and families receive more in federal refundable credits than they pay in federal income tax, the federal income tax reductions are indicated in bold and represent an increase in net federal benefits they receive. Percentages are not meaningful so the dollar amounts are repeated.

Table A7.9

Typical Single Individual – 2000 Budget Annual Impacts

		Proposed 2000 budget			
Total income	Federal tax pre-2000 budget	Total relief (2001)[1]	Total relief as a % of federal tax	Total relief (2004)	Total relief as a % of federal tax
$	$	$	%	$	%
10,000	137	-41	-29.9	-114	-83.5
15,000	899	-49	-5.4	-137	-15.2
20,000	1,695	-49	-2.9	-137	-8.1
25,000	2,492	-49	-2.0	-137	-5.5
30,000	3,529	-128	-3.6	-290	-8.2
35,000	4,875	-214	-4.4	-404	-8.3
40,000	6,129	-314	-5.1	-504	-8.2
50,000	8,729	-514	-5.9	-704	-8.1
60,000	11,354	-739	-6.5	-928	-8.2
75,000	15,864	-953	-6.0	-1,314	-8.3
100,000	23,477	-1,169	-5.0	-1,545	-6.6
125,000	31,089	-1,242	-4.0	-1,617	-5.2

[1] Negative values indicate a reduction in net tax paid to the federal government.

The Five-Year Tax Reduction Plan – Impact on Typical Taxpayers

Table A7.10

Typical One-Earner Family of Four – Annual Impacts of 1997, 1998 and 1999 Budgets and Proposed Five-Year Tax Reduction Plan by 2004

		1997-1999 budget impacts		Proposed tax reduction measures by 2004[1]										
Total Income	Federal tax pre-1997 budget	Total relief[2]	Total relief as a % of federal tax[3]	Increase personal and spousal amounts	Increase 2nd and 3rd brackets	Reduce the middle rate	Eliminate surtax	Enhance Canada Child Tax Benefit	Other indexation	Total relief	Total relief as a % of federal tax[4]	Total relief: 1997 to 2004 budgets	Total relief: 1997 to 2004 as a % of federal tax	Federal tax post-Plan
$	$	$	$/%	$	$	$	$	$	$	$	$/%	$	$/%	$
15,000	-2,946	-1,452	**-1,452**	-173	0	0	0	-869	-55	**-1,097**	**-1,097**	**-2,549**	**-2,549**	-5,495
20,000	-2,126	-1,475	**-1,475**	-274	0	0	0	-869	-55	**-1,198**	**-1,198**	**-2,673**	**-2,673**	-4,799
25,000	-897	-1,103	**-1,103**	-274	0	0	0	-1,268	-55	**-1,597**	**-1,597**	**-2,700**	**-2,700**	-3,597
30,000	461	-498	**-498**	-274	-37	0	0	-1,268	-172	**-1,751**	**-1,751**	**-2,249**	**-2,249**	-1,788
35,000	2,245	-535	-23.8	-274	-487	0	0	-594	-172	-1,526	-89.3	-2,061	-91.8	183
40,000	3,941	-573	-14.5	-274	-487	-150	0	-637	-76	-1,623	-48.2	-2,196	-55.7	1,744
50,000	7,119	-651	-9.1	-274	-487	-450	0	-723	0	-1,934	-29.9	-2,585	-36.3	4,534
60,000	10,322	-730	-7.1	-274	-512	-750	0	-809	0	-2,344	-24.4	-3,074	-29.8	7,248
75,000	15,472	-688	-4.4	-288	-852	-1,103	-2	-920	0	-3,165	-21.4	-3,853	-24.9	11,619
100,000	23,302	-906	-3.9	-288	-852	-1,103	-364	0	0	-2,607	-11.6	-3,513	-15.1	19,789
125,000	31,132	-1,123	-3.6	-288	-852	-1,103	-727	0	0	-2,970	-9.9	-4,093	-13.1	27,039

1 In calculating the amount of the tax reduction by 2004, the following assumptions were made: annual inflation factor of 1.8 per cent on average is used over the five-year period; personal amount – $8,000; spousal/equivalent-to-spouse amount – $6,800; middle tax bracket threshold – $35,000; upper tax bracket threshold – $70,000; middle tax rate – 23 per cent; five-per-cent surtax – eliminated; the Canada Child Tax Benefit base benefit increased by $70 in 2000 (including indexation) then indexed; the rate at which benefits decline with increases in income lowered to 2.07 per cent for a family with one child and 4.14 per cent for a family with two or more children; the threshold at which the base benefit starts to be reduced – $35,000; the National Child Benefit supplement increased by $200 per child by July 2001 (including indexation).

2 Negative values indicate a reduction in net tax paid to the federal government.

3 Where individuals and families receive more in federal refundable credits (Canada Child Tax Benefit, goods and services tax credit) than they pay in federal income tax, the federal income tax reductions are indicated in bold and represent the increase in the net benefits they receive from the tax and transfer system. Percentages are not meaningful so the dollar amounts are repeated.

4 Percentages are based on federal tax after the 1997, 1998 and 1999 budgets.

Table A7.11

Typical Two-Earner Family of Four – Annual Impacts of 1997, 1998 and 1999 Budgets and Proposed Five-Year Tax Reduction Plan by 2004

		1997-1999 budget impacts		Proposed tax reduction measures by 2004[1]										
Total Income	Federal tax pre-1997 budget	Total relief[2]	Total relief as a % of federal tax[3]	Increase personal and spousal amounts	Increase 2nd and 3rd brackets	Reduce the middle rate	Eliminate surtax	Enhance Canada Child Tax Benefit	Other indexation	Total relief	Total relief as a % of federal tax[4]	Total relief: 1997 to 2004 budgets	Total relief: 1997 to 2004 as a % of federal tax	Federal tax post-Plan
$	$	$	$/%	$	$	$	$	$	$	$	$/%	$	$/%	$
15,000	-3,361	-1,210	**-1,210**	0	0	0	0	-869	-55	**-924**	**-924**	**-2,134**	**-2,134**	-5,495
20,000	-3,042	-1,460	**-1,460**	-68	0	0	0	-869	-55	**-992**	**-992**	**-2,453**	**-2,453**	-5,495
25,000	-2,171	-1,480	**-1,480**	-287	0	0	0	-850	-55	**-1,192**	**-1,192**	**-2,671**	**-2,671**	-4,842
30,000	-1,114	-1,252	**-1,252**	-287	0	0	0	-1,230	-55	**-1,572**	**-1,572**	**-2,824**	**-2,824**	-3,938
35,000	6	-582	**-582**	-148	0	0	0	-1,291	-172	**-1,611**	**-1,611**	**-2,192**	**-2,192**	-2,186
40,000	1,326	-507	-38.2	-295	0	0	0	-777	-172	**-1,244**	**-1,244**	**-1,751**	**-1,751**	-424
50,000	3,734	-556	-14.9	-295	-37	0	0	-648	0	-980	-30.8	-1,535	-41.1	2,199
60,000	6,431	-620	-9.6	-295	-487	-30	0	-734	0	-1,546	-26.6	-2,165	-33.7	4,265
75,000	10,450	-628	-6.0	-295	-487	-300	0	-863	0	-1,945	-19.8	-2,573	-24.6	7,877
100,000	16,504	-710	-4.3	-295	-863	-750	0	0	0	-1,909	-12.1	-2,619	-15.9	13,885
125,000	23,828	-924	-3.9	-303	-1,339	-1,358	-60	0	0	-3,059	-13.4	-3,984	-16.7	19,845

[1] In calculating the amount of the tax reduction by 2004, the following assumptions were made: annual inflation factor of 1.8 per cent on average is used over the five-year period; personal amount – $8,000; spousal/equivalent-to-spouse amount – $6,800; middle tax bracket threshold – $35,000; upper tax bracket threshold – $70,000; middle tax rate – 23 per cent; five per-cent surtax – eliminated; the Canada Child Tax Benefit base benefit increased by $70 in 2000 (including indexation) then indexed; the rate at which benefits decline with increases in income lowered to 2.07 per cent for a family with one child and 4.14 per cent for a family with two or more children; the threshold at which the base benefit starts to be reduced – $35,000; the National Child Benefit supplement increased by $200 per child by July 2001 (including indexation).

[2] Negative values indicate a reduction in net tax paid to the federal government.

[3] Where individuals and families receive more in federal refundable credits (Canada Child Tax Benefit, goods and services tax credit) than they pay in federal income tax, the federal income tax reductions are indicated in bold and represent the increase in the net benefits they receive from the tax and transfer system. Percentages are not meaningful so the dollar amounts are repeated.

[4] Percentages are based on federal tax after the 1997, 1998 and 1999 budgets.

Table A7.12

Typical Single Individual – Annual Impacts of 1997, 1998, and 1999 Budgets and Proposed Five-Year Tax Reduction Plan by 2004

		1997-1999 budget impacts		Proposed tax reduction measures by 2004[1]										
Total Income	Federal tax pre-1997 budget	Total relief[2]	Total relief as a % of federal tax[3]	Increase personal and spousal amounts	Increase 2nd and 3rd brackets	Re-duce the middle rate	Elimi-nate surtax	Enhance Canada Child Tax Benefit	Other index-ation	Total relief	Total relief as a % of federal tax[4]	Total relief: 1997 to 2004 budgets	Total relief: 1997 to 2004 as a % of fede-ral tax	Federal tax post-Plan
$	$	$	%	$	$	$	$	$	$	$	$/%	$	$/%	$
10,000	267	-130	-48.7	-148	0	0	0	0	-6	**-154**	**-154**	**-284**	**-284**	-17
15,000	1,053	-154	-14.6	-148	0	0	0	0	-27	-175	-19.5	-329	-31.3	724
20,000	1,873	-178	-9.5	-148	0	0	0	0	-27	-175	-10.3	-353	-18.9	1,520
25,000	2,694	-202	-7.5	-148	0	0	0	0	-27	-175	-7.0	-377	-14.0	2,317
30,000	3,756	-227	-6.0	-148	-37	0	0	0	-144	-329	-9.3	-556	-14.8	3,200
35,000	5,140	-264	-5.1	-148	-487	0	0	0	0	-635	-13.0	-899	-17.5	4,241
40,000	6,432	-302	-4.7	-148	-487	-150	0	0	0	-785	-12.8	-1,087	-16.9	5,345
50,000	9,110	-380	-4.2	-148	-487	-450	0	0	0	-1,085	-12.4	-1,465	-16.1	7,645
60,000	11,813	-459	-3.9	-148	-512	-750	0	0	0	-1,409	-12.4	-1,868	-15.8	9,945
75,000	16,459	-595	-3.6	-155	-852	-1,103	-60	0	0	-2,169	-13.7	-2,765	-16.8	13,695
100,000	24,289	-813	-3.3	-155	-852	-1,103	-422	0	0	-2,532	-10.8	-3,345	-13.8	20,945
125,000	32,119	-1,030	-3.2	-155	-852	-1,103	-785	0	0	-2,894	-9.3	-3,925	-12.2	28,195

[1] In calculating the amount of the tax reduction by 2004, the following assumptions were made: annual inflation factor of 1.8 per cent on average is used over the five-year period; personal amount – $8,000; spousal/equivalent-to-spouse amount – $6,800; middle tax bracket threshold – $35,000; upper tax bracket threshold – $70,000; middle tax rate – 23 per cent; five-per-cent surtax – eliminated.

[2] Negative values indicate a reduction in net tax paid to the federal government.

[3] Where individuals and families receive more in federal refundable credits (goods and services tax credit) than they pay in federal income tax, the federal income tax reductions are indicated in bold and represent the increase in the net benefits they receive from the tax and transfer system. Percentages are not meaningful so the dollar amounts are repeated.

[4] Percentages are based on federal tax after the 1997, 1998 and 1999 budgets.

Table A7.13

Typical Single Parent With One Child – Annual Impacts of 1997, 1998, and 1999 Budgets and Proposed Five-Year Tax Reduction Plan by 2004

		1997-1999 budget impacts		Proposed tax reduction measures by 2004[1]										
Total Income	Federal tax pre-1997 budget	Total relief[2]	Total relief as a % of federal tax[3]	Increase personal and spousal amounts	Increase 2nd and 3rd brackets	Reduce the middle rate	Eliminate surtax	Enhance Canada Child Tax Benefit	Other indexation	Total relief	Total relief as a % of federal tax[4]	Total relief: 1997 to 2004 budgets	Total relief: 1997 to 2004 as a % of federal tax	Federal tax post-Plan
$	$	$	$/%	$	$	$	$	$	$	$	$/%	$	$/%	$
10,000	-2,168	-523	**-523**	0	0	0	0	-444	-45	**-489**	**-489**	**-1,012**	**-1,012**	-3,180
15,000	-2,023	-668	**-668**	0	0	0	0	-444	-45	**-489**	**-489**	**-1,157**	**-1,157**	-3,180
20,000	-1,383	-703	**-703**	-274	0	0	0	-425	-45	**-745**	**-745**	**-1,448**	**-1,448**	-2,831
25,000	-660	-723	**-723**	-274	0	0	0	-434	-45	**-753**	**-753**	**-1,476**	**-1,476**	-2,136
30,000	658	-690	**-690**	-274	0	0	0	-663	-49	**-986**	**-986**	**-1,677**	**-1,677**	-1,018
35,000	1,985	-412	-20.8	-274	-127	0	0	-590	-162	-1,153	-73.4	**-1,566**	-78.9	419
40,000	3,650	-450	-12.3	-274	-487	-30	0	-292	-161	-1,244	-38.9	**-1,694**	-46.4	1,957
50,000	6,578	-528	-8.0	-274	-487	-330	0	-335	0	-1,426	-23.6	**-1,954**	-29.7	4,625
60,000	9,506	-606	-6.4	-274	-487	-630	0	-378	0	-1,769	-19.9	**-2,375**	-25.0	7,132
75,000	14,219	-653	-4.6	-288	-849	-1,050	0	-427	0	-2,613	-19.3	**-3,267**	-23.0	10,952
100,000	22,049	-871	-3.9	-288	-852	-1,103	-306	0	0	-2,549	-12.0	**-3,420**	-15.5	18,629
125,000	29,879	-1,088	-3.6	-288	-852	-1,103	-669	0	0	-2,912	-10.1	**-4,000**	-13.4	25,879

[1] In calculating the amount of the tax reduction by 2004, the following assumptions were made: annual inflation factor of 1.8 per cent on average is used over the five-year period; personal amount – $8,000; spousal/equivalent-to-spouse amount – $6,800; middle tax bracket threshold – $35,000; upper tax bracket threshold – $70,000; middle tax rate – 23 per cent; five-per-cent surtax – eliminated; the Canada Child Tax Benefit base benefit increased by $70 in 2000 (including indexation) then indexed; the rate at which benefits decline with increases in income lowered to 2.07 per cent for a family with one child and 4.14 per cent for a family with two or more children; the threshold at which the base benefit starts to be reduced – $35,000; the National Child Benefit supplement increased by $200 per child by July 2001 (including indexation).

[2] Negative values indicate a reduction in net tax paid to the federal government.

[3] Where individuals and families receive more in federal refundable credits (Canada Child Tax Benefit, goods and services tax credit) than they pay in federal income tax, the federal income tax reductions are indicated in bold and represent the increase in the net benefits they receive from the tax and transfer system. Percentages are not meaningful so the dollar amounts are repeated.

[4] Percentages are based on federal tax after the 1997, 1998 and 1999 budgets.

Table A7.14

Typical Single Elderly – Annual Impacts of 1997, 1998, and 1999 Budgets and Proposed Five Year Tax Reduction Plan by 2004

		1997-1999 budget impacts		Proposed tax reduction measures by 2004[1]										
Total Income	Federal tax pre-1997 budget	Total relief[2]	Total relief as a % of federal tax	Increase personal and spousal amounts	Increase 2nd and 3rd brackets	Reduce the middle rate	Eliminate surtax	Enhance Canada Child Tax Benefit	Other indexation	Total relief	Total relief as a % of federal tax[3]	Total relief: 1997 to 2004 budgets	Total relief: 1997 to 2004 as a % of federal tax	Federal tax post-Plan
$	$	$	%	$	$	$	$	$	$	$	$/%	$	%	$
15,000	407	-135	-33.3	-148	0	0	0	0	-81	-228	-84.0	-364	-89.4	43
20,000	1,283	-161	-12.5	-148	0	0	0	0	-81	-228	-20.4	-389	-30.4	893
25,000	2,158	-186	-8.6	-148	0	0	0	0	-81	-228	-11.6	-415	-19.2	1,743
30,000	3,383	-216	-6.4	-148	-37	0	0	0	-257	-442	-13.9	-658	-19.4	2,725
35,000	4,953	-259	-5.2	-148	-487	0	0	0	-113	-747	-15.9	-1,007	-20.3	3,947
40,000	6,424	-302	-4.7	-148	-487	-150	0	0	-113	-897	-14.7	-1,199	-18.7	5,224
50,000	9,341	-387	-4.1	-148	-487	-450	0	0	-91	-1,175	-13.1	-1,562	-16.7	7,779
60,000	12,765	-457	-3.6	-148	-487	-719	0	0	-554	-1,908	-15.5	-2,365	-18.5	10,400
75,000	18,947	-573	-3.0	-155	-852	-1,103	-24	0	-510	-2,644	-14.4	-3,217	-17.0	15,730
100,000	28,265	-772	-2.7	-155	-852	-1,103	-355	0	0	-2,464	-9.0	-3,236	-11.5	25,029
125,000	36,095	-990	-2.7	-155	-852	-1,103	-717	0	0	-2,827	-8.1	-3,816	-10.6	32,279

[1] In calculating the amount of the tax reduction by 2004, the following assumptions were made: annual inflation factor of 1.8 per cent on average is used over the five-year period; personal amount – $8,000; spousal/equivalent-to-spouse amount – $6,800; middle tax bracket threshold – $35,000; upper tax bracket threshold – $70,000; middle tax rate – 23 per cent; five-per-cent surtax – eliminated.

[2] Negative values indicate a reduction in net tax paid to the federal government.

[3] Percentages are based on federal tax after the 1997, 1998 and 1999 budgets.

Table A7.15

Typical Elderly Couple – Annual Impacts of 1997, 1998, and 1999 Budgets and Proposed Five-Year Tax Reduction Plan by 2004

		1997-1999 budget impacts		Proposed tax reduction measures by 2004[1]										
Total Income	Federal tax pre-1997 budget	Total relief[2]	Total relief as a % of federal tax[3]	Increase personal and spousal amounts	Increase 2nd and 3rd brackets	Reduce the middle rate	Eliminate surtax	Enhance Canada Child Tax Benefit	Other indexation	Total relief	Total relief as a % of federal tax[4]	Total relief: 1997 to 2004 budgets	Total relief: 1997 to 2004 as a % of federal tax	Federal tax post-Plan
$	$	$	$/%	$	$	$	$	$	$	$	$/%	$	$/%	$
15,000	-398	0	**0**	0	0	0	0	0	-36	**-36**	**-36**	**-36**	**-36**	-434
20,000	-373	-25	**-25**	0	0	0	0	0	-36	**-36**	**-36**	**-61**	**-61**	-434
25,000	524	-235	-44.8	-287	0	0	0	0	-164	**-451**	**-451**	**-686**	**-686**	-161
30,000	1,498	-290	-19.4	-287	0	0	0	0	-259	-546	-45.2	-837	-55.9	661
35,000	2,663	-319	-12.0	-287	0	0	0	0	-263	-550	-23.5	-868	-32.6	1,795
40,000	4,131	-361	-8.7	-287	-448	0	0	0	-166	-901	-23.9	-1,262	-30.6	2,869
50,000	7,072	-447	-6.3	-287	-487	-287	0	0	-166	-1,227	-18.5	-1,674	-23.7	5,398
60,000	10,018	-527	-5.3	-287	-487	-581	0	0	-209	-1,564	-16.5	-2,091	-20.9	7,927
75,000	15,957	-646	-4.0	-301	-728	-963	0	0	-607	-2,599	-17.0	-3,245	-20.3	12,712
100,000	25,835	-837	-3.2	-301	-852	-1,103	-229	0	-53	-2,538	-10.2	-3,375	-13.1	22,460
125,000	33,665	-1,055	-3.2	-301	-852	-1,103	-591	0	-53	-2,901	-8.9	-3,955	-11.7	29,710

1 In calculating the amount of the tax reduction by 2004, the following assumptions were made: annual inflation factor of 1.8 per cent on average is used over the five-year period; personal amount – $8,000; spousal/equivalent-to-spouse amount – $6,800; middle tax bracket threshold – $35,000; upper tax bracket threshold – $70,000; middle tax rate – 23 per cent; five-per-cent surtax – eliminated.

2 Negative values indicate a reduction in net tax paid to the federal government.

3 Where individuals receive more in federal refundable credits (goods and services tax credit) than they pay in federal income tax, the federal income tax reductions are indicated in bold and represent the increase in the net benefits they receive from the tax and transfer system. Percentages are not meaningful so the dollar amounts are repeated.

4 Percentages are based on federal tax after the 1997, 1998 and 1999 budgets.

Personal Income Tax

Reinstating Full Indexation

The personal income tax system has been only partially indexed to changes in the consumer price index (CPI) since 1986. Under the current rules, a number of parameters of the personal income tax system are adjusted each year for the percentage change in the CPI exceeding 3 per cent for the 12-month period ending on September 30 of the preceding year. As inflation has been below 3 per cent in recent years, the personal income tax system has effectively not been indexed.

The budget proposes to reinstate full indexation effective January 1, 2000, for all amounts that are presently partially indexed.

The indexation factor for a given taxation year beginning January 1 is the percentage change in the average CPI for the 12-month period ending on September 30 of the previous year relative to the average CPI for the 12-month period ending on September 30 of the year earlier. As an example, the indexation factor effective for January 2000, 1.4 per cent, is the percentage change in the average level of the CPI from October 1, 1998 to September 30, 1999 relative to the average level of the CPI from October 1, 1997 to September 30, 1998.

There are two reasons for the use of this mechanism: first, the indexation formula needs to be one which provides stability in the indexation factor to be used over time; and, second, this indexation factor should be as recent as possible. The first reason leads to the use of averages for the past two years; the second reason leads to the use of this information as of September 30 of last year.

Indexation as of January 1, 2000, means that amounts used for the purpose of calculating tax to be withheld for the 2000 taxation year by employers would be adjusted beginning July 2000. In most cases, this would mean that the annual increase in these amounts would be doubled for the purpose of calculating withholdings for the latter half of the year. Similarly, for the goods and services tax credit and the Canada Child Tax Benefit, the increase in payments for July to December 2000 would be doubled to capture the increase planned for January to June 2000.

These higher levels of benefits from July to December 2000 will be maintained until future indexation raises these benefits further.

Table A7.16 lists the main parameters of the tax system that are currently partially indexed and that are proposed to be fully indexed. As an example, the thresholds for the three tax rates (17 per cent, 26 per cent and 29 per cent) would rise by 1.4 per cent for the taxation year 2000 to $7,231, $30,004 and $60,009 respectively. The table shows both the values as they would have been on January 1, 2000 in the absence of indexation and the increased values resulting from full indexing. Table A7.17 lists other provisions that will be affected by the change to full indexation.

Table A7.16

Parameters to Be Fully Indexed for 2000 Beginning January 1, 2000

	Before 2000 budget	After 2000 budget, as of Jan. 1, 2000
	(dollars)	
Basic personal amount	7,131	7,231
Spousal/equivalent-to-spouse amount	6,055	6,140
Net income threshold	606	614
Taxable income threshold at which the 26-per-cent rate begins to apply	29,590	30,004
Taxable income threshold at which the 29-per-cent rate begins to apply	59,180	60,009
Infirm dependant amount	2,353	2,386
Net income threshold	4,778	4,845
Caregiver amount	2,353	2,386
Net income threshold	11,500	11,661
Age amount	3,482	3,531
Net income threshold	25,921	26,284
Disability amount	4,233	4,293
Medical expense tax credit (METC)		
3 per cent of net income ceiling	1,614	1,637
Refundable METC supplement	500	507
Minimum earnings threshold	2,500	2,535
Family net income threshold	17,419	17,664
Old Age Security repayment threshold	53,215	53,960
Goods and services tax credit		
Adult maximum	199	202
Child maximum	105	106
Single supplement	105	106
Phase-in threshold for the single supplement	6,456	6,546
Family net income threshold	25,921	26,284
Canada Child Tax Benefit	See Tables A7.18 and A7.19	

See Table A7.17 for a list of provisions that are indirectly indexed as they are based on the amounts listed above.

Table A7.17
Other Provisions That Will be Affected by Indexation

- Definition of "eligible child" for the purpose of the child care expense deduction.
- Definition of "preferred beneficiary" for the purpose of the preferred beneficiary election.
- The income threshold of a dependant for determining medical expense tax credit claims in respect of a dependant other than a spouse.
- The formula for determining the transfer to a spouse of unused personal amounts (e.g., age, pension and disability amounts).
- Establishing financial dependency for the purpose of determining the taxation of amounts in a registered retirement savings plan on the death of an annuitant.
- The calculation of the goods and services tax credit in the case of bankruptcy.
- The criteria for deeming resident a dependent child of a deemed resident.

Reducing the Tax Burden for Middle-Income Canadians

Reducing the Middle Tax Rate

The budget proposes to reduce the middle tax rate from 26 per cent to 24 per cent effective July 1, 2000. Tax forms for the year 2000 would show a rate of 25 per cent.

The middle tax rate will drop further to 23 per cent within the next five years.

5-per-cent Surtax

Under the current rules, a 5-per-cent surtax applies to basic federal tax in excess of $12,500 (at an income level of about $65,000). The budget proposes to raise this amount to $18,500 (at an income level of about $85,000) effective July 1, 2000. Raising the surtax threshold to $18,500 of basic federal tax as of July 1, 2000, means that, for the 2000 taxation year, the 5-per-cent surtax would apply on basic federal tax in excess of $15,500.

The budget also proposes to reduce the surtax rate from 5 per cent to 4 per cent effective January 1, 2001.

The 5-per-cent surtax will be eliminated within the next five years.

Canada Child Tax Benefit

The Canada Child Tax Benefit (CCTB) is a key element of federal assistance to families. It is an income-tested benefit that has two components: the CCTB base benefit for low- and middle-income families and the National Child Benefit (NCB) supplement for low-income families.

The budget proposes a five-year plan to increase CCTB benefits by $2.5 billion annually by 2004, divided almost equally between low- and middle-income families. Together with increases announced in previous budgets, annual CCTB benefits will exceed $9 billion in 2004, of which low-income families will receive about $6 billion and middle-income families about $3 billion.

The Government's goal is to increase the maximum CCTB benefit for the first child to $2,400 by 2004 from $1,975, the currently scheduled amount for July 2000. The five-year plan will achieve this objective through a number of actions. First, the CCTB will be fully indexed. Second, both the base benefit and the NCB supplement will be increased beyond indexation. Third, the income thresholds at which the base benefit begins to be reduced and the NCB supplement is fully phased out will be increased. Fourth, the reduction rate for the base benefit will be lowered. Finally, the Children's Special Allowance, which provides benefits parallel to the CCTB to provincial agencies for children in care, will be increased.

The following changes, summarized in Tables A7.18 and A7.19, will be legislated for 2000 and 2001.

- Effective January 2000, CCTB parameters will be fully indexed based on the change in the CPI over the 12-month period ending on September 30 of the preceding year. As the CCTB program year begins in July, benefits will be adjusted in July 2000 and indexation benefits for the January to June 2000 period will be paid in the second half of the year. The higher level of benefits from July to December 2000 will be maintained until future indexation raises benefits further.
- In July 2000, the CCTB base benefit will increase by $70 per child, including indexation. The income thresholds at which the CCTB base benefit begins to be reduced and the NCB supplement is fully phased out will be set equal to the second tax bracket threshold. Consequently, these CCTB thresholds will be fully indexed, as the tax bracket threshold is, and will also follow any increases in the tax bracket threshold beyond indexation.

The income threshold at which the NCB supplement begins to be reduced will also be indexed.

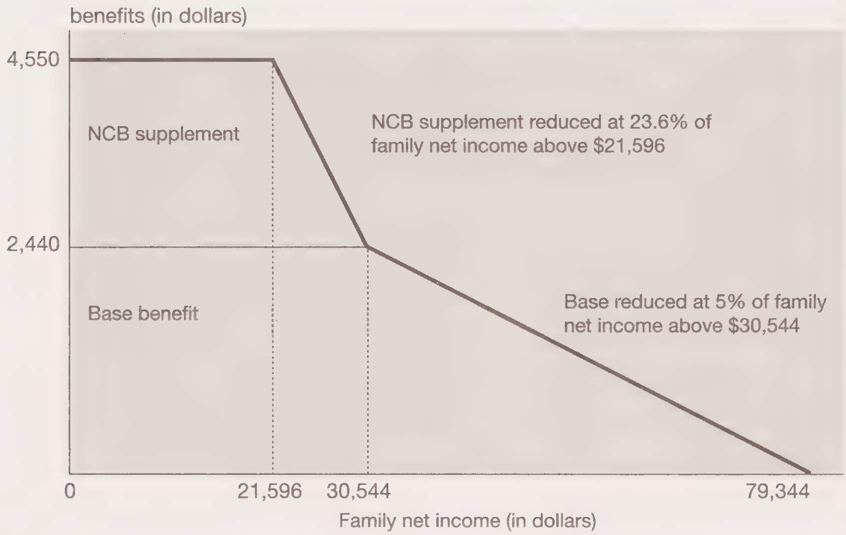
- By July 2001, the NCB supplement will be increased by $200 per child, including indexation, from the currently scheduled July 2000 levels of $955 for the first child, $755 for the second child and $680 for each subsequent child. The $200 benefit increase per child will enrich the NCB supplement by $500 million annually as of July 2001.

Chart A7.1 shows CCTB benefits, income thresholds at which benefits are reduced, and benefit reduction rates for a two-child family in July 2001.

Chart A7.1

CCTB Benefits for Two-Child Family in July 2001

(One child under the age of seven)



These changes will bring the maximum CCTB benefit for the first child to $2,056 in July 2000 and $2,265 in July 2001, well on the way to the five-year goal of $2,400. For the second child, the goal is to raise the maximum CCTB benefit to $2,200 in 2004. There are also additional benefits for children under the age of seven for whom no child care expense is claimed and for larger families. Maximum benefits for a two-child family with one child under the age of seven will reach $4,550 in July 2001 and $4,832 in July 2004.

Benefits for a typical two-child family with an income of $60,000 will increase from their pre-budget 2000 level of $733 to $967 in July 2001 and $1,541 in July 2004.

Table A7.18

Changes to the Components of the Canada Child Tax Benefit

	Maximum benefit (as of July 1999)	Indexed amount 2000[1] (starting January 1)	Maximum benefit 2000[2] (starting July 1)	Maximum benefit 2001[5] (starting July 1)
		(dollars)		
Base Benefit				
Basic amount	1,020	1,034	1,090[3]	1,110
Additional benefit for third child	75	76	76	77
Additional benefit for children under 7 years	213	216	216	220
NCB Supplement				
First child	785	796	966[4]	1,155[6]
Second child	585	593	763[4]	955[6]
Third child	510	517	687[4]	880[6]
Total Benefit				
First child	1,805	1,830	2,056	2,265
Second child	1,605	1,627	1,853	2,065
Third child	1,605	1,627	1,853	2,067

[1] 1.4 per cent increase based on July 1999 benefit level.

[2] Excludes indexation benefits for the January to June period, to be paid in the second half of the year. These benefits are the differences between the first and second columns of the table.

[3] Increase of $70 per child, including indexation.

[4] Includes the $170 per child provided in the 1999 budget. The benefit reduction rates for family income above the threshold will be 11.1 per cent for one-child families, 19.9 per cent for two-child families, and 27.8 per cent for families with three or more children.

[5] For 2001, it assumes an indexation factor of 1.8 per cent.

[6] Increase of $200 per child, including indexation.

Table A7.19

Changes to the Income Thresholds of the Canada Child Tax Benefit

	As of July 1999	Starting July 1, 2000	Starting July 1, 2001
		(dollars)	
Income Thresholds			
Base benefit	25,921	30,004	30,544
NCB Supplement			
Start phase-out	20,921	21,214	21,596
End phase-out	27,750	30,004	30,544

General Tax Relief: Business Taxes

Corporate Tax Rate Reduction

Canada must ensure that its business income tax system is internationally competitive. This is important because business income tax rates have a significant impact on the level of business investment, employment, productivity, wages and incomes.

Canada's tax rates for small businesses and the manufacturing and processing (M&P) sector are already competitive. Also, the resource sector (crude oil, natural gas and mining) benefits from special deductions, such as the resource allowance when it exceeds provincial royalties, accelerated exploration and development expenses and fast write-offs for certain capital assets, all of which serve to reduce its effective tax rate.

However, higher overall corporate tax rates apply to other sectors of the economy. These sectors include the fast-growing service and knowledge-based firms that are likely to influence the pace of Canada's future economic and social development.

In addition, Canada imposes a capital tax on large corporations that is higher than in most G-7 countries.

Therefore, the Government intends to reduce, within five years, the federal corporate income tax rate from 28 to 21 per cent on business income not currently eligible for special tax treatment.

As an initial step in achieving this tax rate reduction, the budget proposes that, effective January 1, 2001, the federal corporate income tax rate on such income be reduced by 1 percentage point from 28 to 27 per cent. This rate change will be prorated for taxation years that include January 1, 2001.

The tax rate reduction will not apply to income that benefits from preferential corporate tax treatment such as small business and Canadian M&P income, investment income that benefits from refundable tax provisions or income from non-renewable natural resource activities. The reduction will also not apply to mutual fund corporations, mortgage investment corporations, and investment corporations (as defined in the Income Tax Act), which qualify for special tax provisions.

Faster Corporate Tax Rate Reduction for Small Business

Canada provides very favourable tax treatment for small business; this has a direct impact on their cost of doing business. For example, the lower tax rate on the first $200,000 of active business income alone provides the small business sector with more than $2.5 billion of tax assistance annually, allowing the retention of earnings for expansion. However, income earned by small businesses in excess of the $200,000 threshold is currently subject to the general corporate tax rate of 28 per cent or, for M&P income, to the 21-per-cent M&P rate.

Small businesses that are currently taxed at the 28-per-cent tax rate on their active business income in excess of the $200,000 small business limit will benefit from the proposed 1 percentage point reduction in the general tax rate next year and from the further reductions planned for the future. However, in order to provide additional and more immediate support for this sector, the budget proposes to advance the planned 7-percentage-point rate reduction for small business.

Specifically, the corporate tax rate on income between $200,000 and $300,000 earned by a Canadian-controlled private corporation (CCPC) from an active business carried on in Canada will be reduced to 21 per cent from 28 per cent, effective January 1, 2001 (prorated for taxation years that include that date).

Associated corporations will share the additional $100,000 of income eligible for the faster rate reduction in proportion to their share of the $200,000 small business limit. Income eligible for this lower rate will be reduced to the extent that a corporation has M&P income subject to the reduced M&P tax rate or income from resource activities.

Table A7.20 illustrates the impact of this faster access to the reduced 21-per-cent rate for a small business.

Table A7.20

	Part I tax based on	
	Existing rates	Proposed rates
Business income	$ 375,000	$ 375,000
Income eligible for:		
Existing small business rate	$200,000	$200,000
Faster access to reduced rate[1]	n/a	$100,000
General corporate rate	$175,000	$75,000
Applicable federal tax rates on:[2]		
Small business income	12%	12%
Income eligible for faster access to the reduced rate	n/a	21%
Remaining income[3]	28%	27%
Applicable surtax on all income[4]	1.12%	1.12%
Part I tax on:		
Small business income	$24,000	$24,000
Income eligible for faster access to the reduced rate	n/a	$21,000
Remaining income	$49,000	$20,250
Surtax	$4,200	$4,200
Total Part I tax	$77,200	$69,450

1 Reduced to the extent that the firm has M&P income subject to the reduced M&P tax rate or income from resource activities.

2 Taking into account the 10-per-cent provincial tax abatement.

3 Excluding resource income (such income will continue to be taxed at 28 per cent) and investment income.

4 The surtax remains at 4 per cent of the 28-per-cent corporate tax rate.

Federal Corporate Tax Rates

Table A7.21 presents the federal corporate tax rates on various types of income, before and after the proposed rate reduction.

Table A7.21

	Current rates	Proposed rates January 1, 2001	Target rates
	(per cent, after provincial tax abatement and before surtax)		
On first $200,000 of CCPC's active business income[1]	12	12	12
On CCPC's active business income between $200,000 and $300,000[2]	28	21	21
On M&P income	21	21	21
On resource income[3]	21	21	21
On other income	28	27	21

[1] The $200,000 limit is reduced where taxable capital exceeds $10 million. Investment income earned by a CCPC will continue to be taxed at 28 per cent, plus the 6⅔ per cent refundable tax on investment income tax. A portion of these taxes is refundable on the payment of dividends in order to provide integration of corporate and personal tax systems.
[2] Reduced to the extent of M&P income subject to a rate reduction or income from resource activities.
[3] After taking into account the 25-per-cent resource allowance deduction.

Capital Gains

The budget proposes that the income inclusion rate for capital gains be reduced to two thirds from the current rate of three quarters for capital gains realized after February 27, 2000. This change ensures that capital gains are taxed at about the same rate as dividends received from taxable Canadian corporations.

Computing Taxable Gains/Allowable Losses in Taxation Year 2000 – For Individuals (and Other Taxpayers With Calendar Taxation Years)

Because this measure becomes effective for capital gains realized after February 27, 2000, two different inclusion rates will apply for the 2000 taxation year. Accordingly, individuals (and other taxpayers with calendar taxation years) will be required to separately report capital gains and losses realized in the period January 1 to February 27 inclusive, and capital gains and losses realized after February 27 for that year. For each period, the net capital gain or loss will have to be computed.

An individual's capital gains inclusion rate for the 2000 taxation year will depend on whether the individual has realized net gains or net losses in one or both periods, or a net gain in one period and a net loss in the other, as outlined below.

Case 1: A Net Gain/Loss in One Period Only

Where there is a net gain or net loss in one period and none in the other, the individual's capital gains inclusion rate for the year will be that applicable to the period in which the net gain or net loss is incurred. That is, if the net gain or net loss is incurred in the period January 1 to February 27, the individual's inclusion rate for the 2000 taxation year will be three quarters; if the net gain or net loss is incurred in the period February 28 to December 31, the individual's inclusion rate for the 2000 taxation year will be two thirds.

Case 2: A Net Gain in Each Period or Net Loss in Each Period

Where there are net gains in both periods, or net losses in both periods, the individual's taxable capital gain/allowable capital loss for the year will be determined by reference to the following formula:

3/4 x (A)+ 2/3 x (B)

where

A = Net gain/loss in the period January 1-February 27, 2000;

and

B = Net gain/loss in the period February 28-
December 31, 2000.

Individuals may need to determine their effective inclusion rate for 2000 for certain purposes, such as loss carryovers. The effective inclusion rate for the year will be the individual's taxable capital gain or allowable capital loss for the year divided by the net gain or loss for the year.

Example 1

Howard sells shares in ABC Corporation on January 30, 2000, for a gain of $500. He sells more ABC shares on March 30, 2000, for a gain of $1,000. Finally, he sells shares in XYZ Inc. on June 1, 2000, for a loss of $250.

Step 1

Howard determines separately his net gains for the periods January 1-February 27 and February 28-December 31. For the first period, his net gain is $500; for the second period, his net gain is $1,000 less $250, or $750.

Step 2

Because he has net gains in both periods, Howard computes his taxable capital gains for 2000 using the separate net gain figures derived in Step 1:

A = $500, B= $750,

Taxable Capital Gains = 3⁄4 x ($500) + 2⁄3 x ($750) = $875

Step 3

To determine his effective capital gains inclusion rate for the year, Howard divides his taxable gain of $875 by his net gain for the year of $1,250 (i.e., $500 plus $750):

Effective Inclusion Rate = ($875) ÷ ($1,250) = 70 per cent

Case 3: A Net Gain in One Period and a Net Loss in the Other

Where an individual has a net gain in one period and a net loss in the other, the net gain or net loss for 2000 will be computed by netting the two. The individual's taxable capital gain or allowable loss for the year will be the net gain or net loss for the year multiplied by the inclusion rate, as determined below.

The inclusion rate for 2000 will be three quarters where:

- the amount of net gains for the period January 1-February 27 exceeds net losses for the period February 28-December 31, or
- the amount of net losses for the period January 1-February 27 exceeds net gains for the period February 28-December 31.

The inclusion rate for 2000 will be two thirds where:

- the amount of net gains for the period January 1-February 27 is less than net losses for the period February 28-December 31, or
- the amount of net losses for the period January 1-February 27 is less than net gains for the period February 28-December 31.

Example 2

Nancy sells shares in XYZ Inc. on February 1, 2000, for a loss of $300. She sells shares in ABC Corporation on June 1, 2000, for a gain of $1,000.

Step 1

Nancy determines separately her net gains and losses for the periods January 1-February 27 and February 28-December 31. For the first period, she has a net loss of $300; for the second period she has a net gain of $1,000.

Step 2

After deducting the net loss of $300, $700 of the post-February 27 gain remains. Nancy's taxable capital gain for the year is determined by multiplying this amount by the post-February 27 inclusion rate of two thirds.

Taxable Capital Gain = 2/3 x $700 = $466.67

Taxpayers With Non-Calendar Taxation Years

For taxpayers whose taxation years do not coincide with the calendar year (such as some corporations), the reduced two-thirds inclusion rate will also apply to capital gains realized after February 27, 2000. Similar to individuals, corporations will be required to report capital gains and losses realized on or before February 27, 2000 separately from those realized after that date.

Loss Carryovers

Net capital losses may be carried back three years or forward indefinitely to offset taxable capital gains of other years. An individual's net capital loss for a year is set by reference to the capital gains inclusion rate for that year.

Where a net capital loss of a given year is used to reduce a taxable capital gain of another year for which the capital gains inclusion rate is different, the amount of the loss is adjusted to match the inclusion rate in effect for the year in which the loss is being applied. The adjustment factor is determined by dividing the inclusion rate for the year the loss is claimed by the inclusion rate for the year in which the loss arose.

Example 3

Howard incurred a loss of $500 in 1999. He wishes to carry forward this loss to reduce his taxable capital gain of $875 in 2000 (see Example 1 above).

Step 1

In 1999, the inclusion rate was three quarters. Howard's net capital loss for 1999 is his loss for 1999 of $500 multiplied by the three-quarters inclusion rate, or $375.

Step 2

Howard has already determined that his inclusion rate for 2000 is 70 per cent (see Example 1). He determines the adjustment factor applicable to his net capital loss for 1999 by dividing his 70-per-cent inclusion rate for 2000 by the three-quarters inclusion rate effective for 1999, the year the loss arose:

Adjustment Factor = (0.70/0.75) = 93.3%

Step 3

To determine the amount of the 1999 net capital loss that Howard may deduct in 2000, Howard multiplies the adjustment factor derived in Step 2 by his net capital loss for 1999:

Loss carried forward to 2000 = 93.3% x $375 = $350

Howard claims the adjusted loss amount of $350 on his 2000 tax return.

Related Items

To reflect the reduction in the capital gains inclusion rate effective February 28, 2000, the appropriate adjustments will be made to related items, including:

- the deductions for amounts included in income in respect of employee stock options, employer shares from a deferred profit-sharing plan, and shares received by prospectors and grubstakers;
- allowable business investment losses;
- the $500,000 lifetime capital gains exemption for qualified small business shares and qualified farm property; and
- the charitable gifting of listed securities (i.e., one-half the otherwise applicable inclusion rate).

Employee Stock Options

Many corporations use stock options to encourage their employees to take an ownership stake in the corporation, most notably in the fast-growing high-technology industries. These options provide employees with the right to acquire shares in their employer for a predetermined price – the exercise price.

The current tax treatment of employee stock options is as follows:

- A taxable employment benefit equal to the difference between the fair market value of the share at the time the option is exercised and the amount paid by the employee to acquire the share is generally included in income in the year the option is exercised.
- In the case of Canadian-controlled private corporations (CCPCs), the taxable employment benefit is generally not included in income until the year of disposition of the share acquired under the option.
- Where certain conditions are met, a deduction in respect of the employee stock option benefit is provided that essentially results in the benefit being taxed at the same rate as capital gains.

To assist corporations in attracting and retaining high-calibre workers and make our tax treatment of employee stock options more competitive with the United States, the budget proposes to allow employees to defer the income inclusion from exercising employee stock options for publicly listed shares until the

disposition of the shares, subject to an annual $100,000 limit (see below). Employees disposing of such shares will be eligible to claim the stock option deduction in the year the benefit is included in income. The new rules will also apply to employee options to acquire units of a mutual fund trust. The proposed rules are generally similar to those for Incentive Stock Options in the United States.

Employee stock options granted by CCPCs are not affected by the proposed measure.

Eligible Employees

Eligible employees are those who at the time the option is granted:

- deal at arm's-length with the employer and any related corporation; and
- are not specified shareholders (specified shareholders are generally those who own 10 per cent or more of a company's shares).

Eligible Options

An eligible option is one under which:

- the share to be acquired is an ordinary common share;
- the share is of a class of shares traded on a prescribed Canadian or foreign stock exchange; and
- the total of all amounts payable to acquire the share, including the exercise price and any amount payable to acquire the option, is not less than the fair market value of the share at the time the option is granted.

The proposal applies to eligible options exercised after February 27, 2000, irrespective of when the option was granted or became vested.

$100,000 Limit

There will be a $100,000 annual limit on the amount of options that an employee can be granted which will be eligible for deferral.

The same limit applies in the United States. This limit will apply:

- to the value of the stock options that vest (first become exercisable) in the employee each year (the "value of a stock option" is the fair market value of the underlying share at the time the option is granted); and
- across all stock option plans of the employer corporation and related corporations.

Example

Gerry is an employee of a company that has an employee stock option plan. On January 1, 2001, Gerry's employer grants options to acquire 16,000 shares. Options to acquire 4,000 shares vest immediately, and the remaining options vest in equal parts on January 1 of each of 2002, 2003 and 2004. The fair market value of the shares on January 1, 2001 is $10.

Because, at the time the options were granted, the fair market value of the shares underlying the options that vest in each of the years 2001-2004 does not exceed $100,000, Gerry will be able to defer the income inclusion from exercising all the options.

Had the options all vested in the same year, only 10,000 of the underlying shares would have qualified for the deferral.

There are no restrictions on how many of the options Gerry can exercise in any given year.

Reporting Arrangements

Deferral of taxation of the employment benefit arising from the exercise of an employee option will depend on the employer having an arrangement in place to ensure that:

- the employer, or an agent of the employer, can monitor compliance with the $100,000 limit; and
- the related employment benefit and the stock option deduction can be reported on an information slip in the year the share is disposed of.

Consultations will be held in the coming months with stakeholders and other interested parties on the design of appropriate reporting arrangements. It is intended that specific proposals based on these consultations will be made public in sufficient time for employers to have reporting arrangements in place by the end of this year.

Deferral Period

The income inclusion for a share acquired under an employee stock option will be deferred until the time the employee disposes of the share or, if earlier, the time the employee dies or becomes a non-resident.

The measure applies to options exercised after February 27, 2000.

Capital Gain Rollover for Investment in Small Business

To improve access to capital for small business corporations, the budget proposes to permit individuals a rollover of capital gains on the disposition of a small business investment where the proceeds of disposition are used to make other small business investments. The cost base of the new investment will be reduced by the capital gain deferred in respect of the initial investment.

Eligible Small Business Investment

An eligible small business investment will have the following characteristics:

- the investment is in ordinary common shares issued from treasury to the investor;
- the corporation is, at the time the shares are issued, an eligible small business corporation – which will generally be defined as a Canadian-controlled private corporation all or substantially all of the assets of which (measured by value) are used in an active business carried on primarily in Canada, or are shares of other related eligible small business corporations;
- the total carrying value of the assets of the corporation and related corporations does not exceed $2.5 million immediately before the investment is made, and does not exceed $10 million immediately after the investment. There will be look-through rules to account for assets held by the corporation through partnerships and trusts; and
- while the investor holds the shares, the issuing corporation is an eligible active business corporation – which will generally be defined as a taxable Canadian corporation all or substantially all of the assets of which (measured by value) are used in an active business carried on primarily in Canada, or are shares of other related eligible active business corporations.

The measure is designed to accommodate rollovers of gains irrespective of the company's size at the time of sale or the fact that it may have gone public before the sale.

The eligible small business investment must be held for more than six months from the time of acquisition before a gain can be deferred. The replacement eligible investment must be purchased after the beginning of the year of disposition of the original small business investment, and before the earlier of the 120th day following the disposition and the 60th day after the end of the year.

Eligible Investor

The measure will be available to individuals (other than trusts). Further, an individual who acquires shares from a related individual on a rollover basis currently provided under the Income Tax Act (e.g., on death or marriage breakdown) will be considered for the purpose of this measure to have acquired the shares at the time and under the same circumstances that they were acquired by that related individual.

The measure will also be available to individuals in respect of their capital gains on eligible small business investments that are held through a qualifying pooling arrangement. It is contemplated that such an arrangement will be a special-purpose partnership that is treated for the purpose of these rules as a joint venture – effectively allowing the investment vehicle to act as the investment agent for a number of investors, and to pool investments for those investors, while treating each investor as having his or her own share portfolio within the vehicle.

The issues related to the application of the measure to capital gains realized through a qualifying pooling arrangement will be the subject of consultations with stakeholders and other interested parties.

Eligible Gains

The deferral will be available in respect of capital gains realized after February 27, 2000, on up to $500,000 of eligible small business investments (by reference to adjusted cost base) in any particular corporation (or related group) made by an eligible investor or by a qualifying pooling arrangement on behalf of the investor.

Investment Limit

A capital gain from the disposition of an eligible investment can be deferred to the extent that the proceeds are reinvested in one or more other eligible small business investments. There are no limits on the total amount of proceeds that can be reinvested, but no amount reinvested in excess of $500,000 in shares of a particular corporation or related group will qualify for additional capital gain deferral.

Calculation of Capital Gain Deferral

The maximum capital gain that can be deferred in respect of an eligible capital gain from the disposition of an eligible small business investment is determined by the following formula:

$(A/B) \times C$

where:

A = the total cost of all replacement eligible small business investments (not exceeding $500,000 in any particular corporation or related group);

B = the proceeds of disposition that relate to the eligible gain; and

C = the eligible gain from the disposition.

This measure will apply to eligible small business investments disposed of after February 27, 2000.

Example 1

On March 31, 2000, Harold sells his shares in Corporation A which are eligible small business investments. His proceeds of disposition are $100,000 and his capital gain is $60,000. On July 1, 2000, Harold invests $90,000 in shares of Corporation B which are new eligible small business investments.

Since Harold reinvests only nine tenths of the proceeds in replacement small business investments, he can defer only nine tenths of the gain ($54,000). He therefore has a $6,000 capital gain from the disposition for the year.

Harold's adjusted cost base of the Corporation B shares is reduced from $90,000 to $36,000 because of the capital gains deferral of $54,000.

Example 2

On November 30, 2000, Kate disposes of shares in Corporation C which are eligible small business investments. Her proceeds of disposition are $1,000,000 and she realizes a capital gain of $600,000. On February 1, 2001, Kate acquires shares in Corporation D at a cost of $1,000,000 which are new eligible small business investments.

Since the investment limit in respect of a corporation or a related group of corporations is $500,000, Kate can defer capital gains on up to one half of her eligible capital gains of $600,000 (i.e., $300,000). After the deferral, she has a capital gain from the disposition for the year of $300,000.

Kate's adjusted cost base of the Corporation D shares is reduced by the $300,000 deferred gain, from $1,000,000 to $700,000.

If Kate had instead reinvested $500,000 each in shares of two unrelated corporations that were eligible small business investments, she would have been able to defer all of the $600,000 eligible gain. In this case, the adjusted cost base of each of the two new investments would have been reduced by $300,000.

Example 3

Robert has shares in Corporation X which are eligible small business investments having an adjusted cost base of $1,000,000. He sells the shares for proceeds of disposition of $3,000,000 and realizes a capital gain of $2,000,000. Because of the $500,000 investment limit, only the capital gains relating to $500,000 of the original investment are eligible for a deferral. Robert purchases replacement eligible small business investments in six other unrelated corporations of $500,000 each for a total reinvestment of $3,000,000.

While Robert's cost of the replacement eligible small business investment is $3,000,000, the maximum amount he can use to calculate his capital gains deferral is $1,500,000, which is equal to the proceeds of disposition that relate to the eligible gain.

The maximum capital gains deferral that Robert can claim is $1,000,000.

Specific Tax Changes: Personal Income Tax Measures

Foreign Property Rules

The foreign property rule (FPR) in respect of deferred income plans generally limits the amount of foreign property that such a plan can hold. Foreign property generally consists of shares, units and debt issued by non-resident entities. The limit is currently 20 per cent, having been raised from 10 per cent between 1990 and 1994.

The FPR attempts to strike a balance between ensuring that a significant portion of tax-assisted retirement savings is invested in Canada and providing appropriate diversification opportunities for the retirement savings of Canadians.

The budget proposes to raise the FPR limit to 25 per cent for 2000 and 30 per cent after 2000. Increasing the limit has been advocated by committees of the House and Senate and a number of other organizations and groups.

"3 for 1 Bump"

The existing FPR contains a special rule designed to encourage investment by deferred income plans in small businesses operated in Canada. Under the rule, an extra $3 of foreign property "room" is available to a deferred income plan for every $1 invested by the plan in a qualifying small business property. However, the extra foreign property "room" generated cannot result in a plan's foreign content exceeding a 40 per cent limit.

As a result of the increase in the FPR limit generally, the limit with regard to small business investment will be increased to 45 per cent for 2000 and 50 per cent after 2000.

Extension of FPR Rules to Segregated Funds

Although the FPR currently applies to mutual funds which issue units to deferred income plans, there is currently no legislation providing for its application to segregated funds. Segregated funds are insurance products offered by life insurers which are broadly analogous to mutual funds. As announced by the Minister of Finance by press release on October 27, 1998, proposed rules to extend the FPR to segregated funds were to be effective as of January 2001.

The FPR for segregated funds will contain the same one-year lag as is provided for mutual funds (i.e., an interest in a mutual fund is generally not treated as foreign property during a year, provided the mutual fund satisfied the FPR limit throughout the previous year). In order to provide a better opportunity for insurance companies to institute systems changes to allow foreign property levels to be monitored for segregated funds, the budget proposes that the FPR for segregated funds apply after 2001 (rather than after 2000).

Reduction in Federal Surtax for Non-Residents

Individuals who have income which is considered to have been earned in Canada, but which is not considered to be earned in a province, pay a special federal surtax in addition to their regular federal tax. Individuals with such income include

- deemed residents, such as members of the Armed Forces who reside outside of Canada and therefore have no province of residence;
- Canadian residents with income from a permanent establishment in a foreign country; and
- non-residents who have business or employment income taxable in Canada.

The federal surtax for non-residents, which is currently 52 per cent of basic federal tax, ensures that deemed residents and others with income not earned in a province face a total income tax burden roughly comparable to that of Canadian residents. The surtax, which was introduced in 1972, is calculated to approximate provincial taxes. The surtax percentage has been adjusted on several occasions since 1972 to reflect changes in average provincial tax rates.

In light of recent changes in provincial tax rates, the budget proposes to reduce the federal surtax on income not earned in a province from 52 per cent of basic federal tax to 48 per cent.

This measure will apply for the 2000 and subsequent taxation years.

Enhanced Tax Assistance for Persons with Disabilities

The Government is committed to promoting the full participation of persons with disabilities in Canadian society. The budget provides additional tax assistance for persons with disabilities by expanding eligibility for and transferability of the disability tax credit, recognizing the contribution of caregivers of children with severe disabilities, and recognizing additional disability-related costs. These measures will be effective for 2000 and subsequent years.

Enhancing the Disability Tax Credit

The disability tax credit (DTC) recognizes the effect of a severe and prolonged disability on an individual's ability to pay tax. It provides tax relief to over 500,000 claimants at an annual cost of $280 million.

To be eligible for the DTC, an individual must have a severe and prolonged disability that markedly restricts the ability to perform a basic activity of daily living.

The basic activities of daily living include perceiving, thinking and remembering, feeding and dressing oneself, speaking, hearing, eliminating and walking. An individual's ability to perform these activities is markedly restricted only where, even with the use of appropriate devices, medication and therapy, the individual is blind, or unable to perform the activity.

Consistent with representations made by organizations representing persons with disabilities, the budget proposes extending eligibility for the DTC to individuals who must undergo therapy several times each week totalling at least 14 hours per week in order to sustain their vital functions. In such cases, the severity of the disability is evident in the requirement for extensive therapy that is essential to the individual's survival. Examples of persons who may be eligible for the DTC under the proposed change include individuals with severe kidney disease requiring dialysis in order to prevent renal failure, and individuals with severe cystic fibrosis requiring clapping therapy in order to breathe. It is estimated that this change will increase the number of persons eligible for the DTC by about 18,000, at a cost of $13 million annually.

The budget also proposes to expand the list of relatives to whom the DTC can be transferred, making it consistent with the medical expense tax credit rules. As a consequence, unused amounts of the

DTC may be transferred to individuals supporting a brother, sister, aunt, uncle, niece or nephew, as well as to individuals supporting a spouse, child, grandchild, parent or grandparent.

Assistance for Caregivers of Children with Severe Disabilities

The infirm dependant credit and caregiver credit provide tax assistance for the care of infirm dependent adult relatives and seniors. This budget provides additional tax assistance for families caring for children with severe disabilities through a supplement for children eligible for the DTC. The supplement amount will be $2,941 and will reduce federal taxes payable by up to $500. The $500 supplement credit will be in addition to the $730 federal tax value of the disability tax credit as of January 1, 2000. The $2,941 supplement amount will be reduced by the amount of child care expenses and attendant care expenses claimed, in respect of the child, exceeding $2,000. This reduction will target tax assistance to families providing unpaid care for children with severe disabilities. The supplement is reduced to zero when child care and attendant care expenses reach $4,941. It is estimated that this supplement will benefit about 40,000 children eligible for the DTC at a cost of $20 million annually.

The Child Care Expense Deduction for Persons Eligible for the DTC

A child care expense deduction of up to $7,000 annually is currently available in respect of persons eligible for the DTC. The budget proposes to increase this limit to $10,000.

The Medical Expense Tax Credit and New Homes

The medical expense tax credit (METC) provides tax recognition for above-average medical expenses incurred by individuals. For 2000, the METC reduces the federal tax of a claimant by 17 per cent of qualifying unreimbursed medical expenses in excess of the lesser of $1,637 and 3 per cent of net income.

Currently, an individual who lacks normal physical development or has a severe and prolonged mobility impairment may be eligible for the METC in respect of renovation costs incurred to enable the individual to gain access to or to be mobile or functional within the home. The budget proposes to extend tax assistance to such individuals who incur reasonable expenses relating to the construction of a principal place of residence where the expenses

can reasonably be considered to be incremental costs incurred to enable the individual to gain access to or to be mobile or functional within the home.

The Deduction for Attendant Care and Students

The current attendant care provisions allow a deduction in respect of a person with a severe disability for the cost of an attendant required in order for the person to be employed, carry on business or carry on funded research. The budget proposes expanding this deduction to include the cost of an attendant required in order to attend school. The deduction will be subject to a maximum of two thirds of earned income plus, where the taxpayer attends a designated educational institution or a secondary school, two thirds of the lesser of (a) the taxpayer's income from other sources (up to a maximum of $15,000) and (b) $375 times the number of weeks of attendance at the institution or school.

Personal-Use Property

Currently, the adjusted cost base and proceeds of disposition of personal-use property are deemed to be at least $1,000 for capital gains purposes. This rule is designed to ease the compliance and administrative burden associated with the reporting of dispositions of personal-use property. Personal-use property is generally property that is used primarily for the personal use or enjoyment of an individual and includes jewellery, works of art, furniture and clothing.

Certain charitable donation arrangements have been designed to exploit the $1,000 deemed adjusted cost base for personal-use property and to create a scheme under which taxpayers attempt to achieve an after-tax profit from such gifts. For example, arrangements have been designed under which a promoter acquires a number of objects for less than $50 each, invites taxpayers to purchase the objects for $250 each, and arranges for their appraisal at $1,000 each and their donation to a charity.

Based on the $1,000 appraised value, there would be a $750 capital gain per item to the donor but for the $1,000 deemed adjusted cost base for the gift. However, with the deemed adjusted cost base there is no gain for tax purposes. As a result, the cost to governments of the "$1,000 gift" is approximately $500 (i.e., the federal and provincial tax savings associated with a $1,000 charitable donation), which in many cases exceeds the

amount that the charity can realize from the donated property. Such an arrangement intends that the "donor" achieve a tax-free profit of $250.

The budget proposes to amend the Income Tax Act so that the $1,000 deemed adjusted cost base and deemed proceeds of disposition for personal-use property will not apply if the property is acquired after February 27, 2000, as part of an arrangement in which the property is donated as a charitable gift.

Charitable Donations: Designations in Favour of Charity

An individual who is an annuitant under a registered retirement savings plan (RRSP) or registered retirement income fund (RRIF) or the owner of a life insurance policy may wish to have the proceeds in respect thereof donated to a charity on the individual's death. There are two common ways of achieving this goal:

- the individual's will can provide for a cash bequest of the proceeds to the charity; or
- without making any provision in the individual's will, the individual can designate that the proceeds be paid directly to the charity under the terms of the RRSP, RRIF or insurance policy.

In either case, the individual's estate is responsible for satisfying the individual's income tax liabilities on the individual's death.

Under current income tax rules, donations that are made by way of a donor's will qualify for the charitable donations tax credit on death. However, donations made as a consequence of a direct designation do not qualify for the credit. In such circumstances, the charitable donations tax credit would not be available to offset income tax arising because of the taxation of an RRSP or RRIF on death. This can lead to liquidity problems for an estate.

In order to provide consistency in the income tax rules in this regard, the budget proposes to extend the charitable donations tax credit to donations of RRSP, RRIF and insurance proceeds that are made as a consequence of direct beneficiary designations. This measure will apply in respect of an individual's death that occurs after 1998.

Ecologically Sensitive Lands

The protection of Canada's natural heritage, and especially its species at risk, is a critical objective of the Government. The 1995 budget announced incentives for ecological gifts to the Government of Canada, provincial governments, Canadian municipalities or approved registered charities established for the purpose of protecting Canada's environmental heritage. To be eligible for the special provisions, a gift must be a property certified as ecologically sensitive by the Minister of the Environment. The preservation of these properties is critical to the Government's strategy for the protection of species at risk and the promotion of Canada's system of national and provincial parks and other environmental objectives. This strategy emphasizes providing assistance to encourage Canadians to take voluntary action to protect species and to make responsible stewardship an easy choice.

Donations of ecologically sensitive land from individuals are eligible for the charitable donations tax credit, while those from corporations are eligible for a charitable donation deduction. These provisions apply to transfers of title as well as to covenants, easements and servitudes established under common law, the Civil Code in Quebec, or provincial or territorial legislation allowing for their establishment. Further, ecological gifts are exempt from the rules which would otherwise limit the amount of charitable donations eligible for tax assistance in a year to 75 per cent of net income.

Normally, the value of a donated property is determined to be the price that a purchaser would pay for the property on the open market. As there is no established market for covenants, easements and servitudes, the fair market value of such restrictions on land use is difficult to determine. To provide greater certainty in making these valuations, the 1997 budget introduced a measure to deem the value of these gifts to be not less than the resulting decrease in the value of the land.

The budget proposes a further enhancement of the incentives for the protection of ecologically sensitive lands, including areas containing habitat for species at risk. Specifically, it is proposed that the income inclusion be reduced by one-half in respect of capital gains arising from gifts of ecologically sensitive land and related easements, covenants and servitudes to qualified donees other than private foundations.

Because of the amount of tax assistance offered and the difficulty of valuing such donations, it is proposed that the value of all ecological gifts be determined by a special process to be established by the Minister of the Environment. The value determined by the Minister of the Environment may be appealed to the Tax Court of Canada after an irrevocable gift has been made. This valuation process, together with the certification of the ecological importance of the property, will help to ensure that such donations are effectively and efficiently directed toward the protection of Canada's natural heritage.

These measures will be effective for ecological gifts made after February 27, 2000.

The measures with respect to ecologically sensitive land are examples of how the tax system can be used to support the Government's overall environmental policy. Other examples include accelerated depreciation for energy conservation equipment and tax relief for ethanol and methanol used in gasoline-blended fuels.

Offsetting of Interest on Personal Tax Overpayments and Underpayments

An individual who has made an overpayment of income tax may be entitled to receive refund interest from the government on the overpayment. Refund interest is included in income for tax purposes, in the same manner as interest from other sources.

If, on the other hand, an individual has failed to pay an amount of income tax when due, the individual is required to pay arrears interest to the government. Arrears interest is not deductible in computing a taxpayer's income for tax purposes.

The taxation of refund interest and non-deductibility of arrears interest can produce inappropriate results in situations where an individual who owes interest on unpaid tax from one taxation year is concurrently owed interest on a tax overpayment from a different taxation year. In this circumstance, the cost of the non-deductible interest payable by the individual exceeds the after-tax value of the taxable interest receivable by the individual. In many instances, this difference results from the non-deductibility of interest paid and the inclusion in income of interest received.

This budget proposes a relieving mechanism for these individuals. Refund interest accruing over a period will be taxable only to the extent that it exceeds any arrears interest that accrued over the same period to which the refund interest relates. As under current practice, the individual's notice of assessment will indicate the full amount of refund interest. In addition, the Canada Customs and Revenue Agency will issue an information slip indicating the amount, if any, of the refund interest that must be included in the individual's income for tax purposes.

This measure will apply to individuals other than trusts in respect of arrears and refund interest amounts that accrue concurrently after 1999, regardless of the taxation year to which the amounts relate.

Charitable Donations of Shares Acquired with Employee Stock Options

The 1997 budget halved the inclusion rate on capital gains arising from charitable donations made before 2002 of listed securities, such as shares, bonds, bills, warrants and futures.

An individual who acquires a share under an employee stock option plan is required to include in income an employment benefit equal to the fair market value of the share, less any amounts paid to acquire the share. If certain conditions are satisfied, the individual is allowed to deduct part of the employment benefit in order to effectively tax the benefit at capital gains rates.

However, where the employee exercises the option in order to donate the share to a charity, there is no provision to reduce the tax burden on the employment benefit to parallel the reduced capital gains inclusion rate for donations of publicly-traded securities. The budget therefore proposes to introduce such a provision in order to provide parallel treatment between the two forms of gift-giving. In such circumstances, the individual will be allowed to deduct an additional third of the employment benefit. Taking into account the changes proposed in this budget to increase the existing stock option deduction from a quarter to a third, only a third of the employment benefit will be subject to tax.

If the value of the share at the time it is donated is less than when the option was exercised, the additional deduction will be reduced to provide the appropriate amount of tax assistance.

To be eligible for this measure, the share must be donated in the year and within 30 days of the option being exercised. Also, the share will have to meet the existing criteria for the reduced capital gains inclusion rate for donations of publicly-traded securities. The restrictions on eligible charities will also be the same. In addition, the conditions for the existing stock option deduction will have to be satisfied – principally, that the share be an ordinary common share and that amounts payable to acquire the share be no less than the fair market value of the share at the time the option is granted.

The measure will also apply to the donation of units of a mutual fund trust acquired under an employee option plan.

The measure will apply to securities acquired after February 27, 2000, and donated before 2002.

Partial Exemption for Scholarships, Fellowships and Bursaries

The first $500 of scholarship, fellowship or bursary income received in a year has been excluded from income for tax purposes since 1972.

In order to provide additional assistance to students, the budget proposes to increase the annual exemption to $3,000, beginning with the 2000 taxation year. The $2,500 increase in the exemption will apply only to amounts received by a student where that student enrols in a program which entitles the student to claim the education tax credit. Generally, this includes programs at a post-secondary level and programs at educational institutions certified by the Minister of Human Resources Development that furnish or improve skills in an occupation.

Specific Tax Changes: Business Tax

Strengthening Thin Capitalization Rules

The Income Tax Act contains rules that restrict the interest deduction that a corporation resident in Canada can claim in respect of debt owing to a specified non-resident – generally, a shareholder whose stake in the corporation represents 25 per cent or more of the votes or value in the corporation or a person who is not at arm's-length with such a shareholder. Under these so-called "thin capitalization" rules, the Canadian corporation may deduct interest on debt to specified non-residents to the extent that such

debt does not exceed three times the amount of equity contributed by such non-residents. In the event that such debt exceeds the 3:1 ratio, the interest deduction attributable to the excess is denied for Canadian tax purposes.

A number of factors support modifications to the thin capitalization rules, which were introduced in 1972. First, the permitted 3:1 debt-equity ratio is high compared to actual industry ratios in the Canadian economy, suggesting that the 3:1 ratio permits inappropriately high debt levels. On the other hand, the current rules apply to reduce the amount of interest deductible if debt to specified non-residents at any point in the year exceeds the permitted ratio relative to equity. Therefore, temporarily high debt levels can have a disproportionate impact.

The scope of debts covered by the rules is also very narrow. An anti-avoidance rule in the current law deals with so-called back-to-back arrangements. Where a specified non-resident makes a loan to a third party on condition that the third party make a loan to the Canadian corporation, the lesser amount of the two loans is deemed to be a loan to the corporation from the specified non-resident. This rule does not extend, however, to an arrangement where a Canadian corporation borrows funds from a third party with the aid of a guarantee from a specified non-resident. Such a borrowing is often economically equivalent to a direct loan from the non-resident since the guarantee supports the lender's credit risk associated with the borrowing. This type of arrangement can result in the erosion of the tax base to the same extent as a direct loan from the specified non-resident.

In addition, as a result of a special exemption introduced in the early 1970s, the thin capitalization rules currently do not apply to a corporation whose principal business in Canada is the developing or manufacturing of aircraft or aircraft components. It is not apparent that this exemption is warranted under present conditions.

Finally, other changes to the thin capitalization rules need to be considered. The rules currently apply only to corporations and not to other business arrangements such as partnerships, trusts and branches. Taxpayers may therefore be able to use these structures in order to circumvent the rules. There is also concern that use of financing techniques that do not rely on traditional debt – such as leases from a non-resident parent – may weaken the effectiveness of the rules in protecting the Canadian tax base.

In response to these concerns, the budget proposes that the thin capitalization rules in subsections 18(4) to 18(8) of the Income Tax Act be amended in the following manner:

- *The threshold debt-equity ratio in subsection 18(4) will be lowered from 3:1 to 2:1.* The new ratio provides a better measurement of excessive reliance on related-party debt financing in the context of actual Canadian industry debt-equity ratios.
- *The debt-equity ratio will be calculated on an averaged basis.* Specifically, average debt for a fiscal year will be calculated as the average of monthly amounts, each of which is the highest amount of debt to specified non-residents outstanding at any time in the month. Of the three components of equity, retained earnings will continue to be measured at the beginning of the year. The amount of paid-up capital and contributed surplus attributed to specified non-residents will be an average of amounts calculated at the beginning of each month during the taxation year. This manner of applying the limitation will give less weight than the current rules to debt levels that are temporarily high.
- *The conditional loan rule in subsection 18(6) of the Act will be broadened.* The rule will encompass loans to a Canadian corporation from a third party that are guaranteed or secured by a specified non-resident.
- *The exemption for developers and manufacturers of aircraft and aircraft components in subsection 18(8) of the Act will be repealed.*

These four changes will come into effect for taxation years that begin after 2000.

Finally, consultations will be initiated on the extension of the thin capitalization rules to other arrangements and business structures, namely:

- Partnerships that have non-resident members, trusts that have non-resident beneficiaries, and Canadian branches of non-resident companies carrying on business in Canada. Because these arrangements do not involve the issuance of share capital, it is not possible to assess on the basis of the current rules whether or not the entity is “thinly capitalized.” Therefore, the rules would have to be adapted in order to measure excessive indebtedness for such vehicles.

- Debt substitutes, such as certain types of leases.

The Government invites public comments with respect to both the proposed changes outlined above and the extension of the thin capitalization rules to other arrangements and business structures.

Non-Resident-Owned Investment Corporations

Section 133 of the Income Tax Act allows a foreign-owned Canadian corporation to elect to be a "non-resident-owned investment corporation" (NRO). By so doing, income received by the corporation is taxed at the same 25-per-cent rate that would apply to income paid to a non-resident from a Canadian source that is subject to the maximum rate of Part XIII withholding tax. The tax is then refunded when the NRO pays dividends to its foreign parent, at which time withholding tax applies on the dividends. The intended effect of the provision is to place the non-resident shareholder of the NRO in a position similar to that of non-resident investors who hold investments directly.

However, NROs are increasingly being used in ways that erode the Canadian tax base. For example, an NRO may be used to lend money indirectly to an affiliated Canadian corporation. This transaction results in an interest deduction at full rates for the Canadian corporation, while the interest income is subject only to a refundable 25-per-cent tax in the NRO's hands. In addition, this tax planning strategy can allow a double interest deduction for non-resident shareholders, if these shareholders borrow money in order to invest in the NRO.

The budget proposes to repeal the NRO provisions for elections made after February 27, 2000. To allow for an orderly restructuring of their operations, existing NROs will be entitled to retain their status until the end of their last taxation year that begins before 2003. However, existing NROs will not be allowed to issue new shares, other than by way of reorganization, or increase debt levels to finance new investments, subject to grandfathering of arrangements in writing entered into before February 28, 2000.

Weak Currency Borrowings

"Weak currency borrowings" are transactions that take advantage of the fact that, where a currency is expected to decline in value relative to some reference currency, the interest rate on a loan in the "weak" currency will be higher than on a loan on similar terms in the reference currency. The higher rate reflects the market's expectation that the borrowed amount will be worth less in terms of the reference currency when the loan is repaid. Lenders demand a higher interest rate to compensate for this expected depreciation.

A taxpayer pursuing tax advantages may borrow in a weak currency, even though that currency is not required in its business. The proceeds of the weak currency loan are converted into a currency that is needed for business purposes, but the interest obligation remains in the weak currency at the higher rate. The higher interest payments form the basis for a claimed interest deduction that is higher than would be available if the taxpayer had borrowed directly in the final currency. If, as expected, the currency of the borrowing depreciates, the taxpayer will realize a foreign exchange gain on maturity when the principal of the loan is repaid in the depreciated foreign currency. While this gain compensates for the higher interest payments, the taxpayer may treat it as a capital gain, which would be taxed at a preferential rate. The full deduction of additional interest, coupled with capital gains treatment of the offsetting appreciation, produces an inappropriate result which has been challenged by the Canada Customs and Revenue Agency.

The Supreme Court of Canada has recently ruled that specific rules in the Income Tax Act do not deny the tax benefits sought by proponents of these weak currency structures. However, the disputed transaction preceded the introduction of the Act's General Anti-Avoidance Rule (GAAR). The Government's position that the GAAR applies to weak currency borrowings is currently being adjudicated by the courts.

While the Government is pursuing its challenge of these transactions under the current law, prudent risk management supports the introduction, for greater certainty, of specific legislative rules defining particular weak currency arrangements and setting out their appropriate tax treatment. Essentially, a weak currency borrowing will be treated for tax purposes as equivalent to a direct borrowing in the currency that is used by the taxpayer to earn income.

The proposed rules will apply when a taxpayer incurs foreign currency indebtedness that meets the following conditions:

- the proceeds from the indebtedness are not used directly in the currency of the debt, but rather are converted into another currency and used in that form by the taxpayer;
- the interest rate on the debt is more than two percentage points above the rate on an equivalent borrowing in the currency used to earn income; and
- the principal amount of the debt exceeds $500,000.

Where these conditions are met, the following rules will apply:

- deductible interest on the indebtedness will be limited to the interest that would have been payable if the taxpayer had incurred an equivalent debt directly in the currency of use;
- the total of interest expenses disallowed over the term of the indebtedness will be subtracted from the foreign exchange gain or loss realized when the debt is repaid; and
- any foreign exchange gain or loss realized on repayment of the debt, and the gain or loss on any associated hedge, will be on income account.

The measure will not apply to corporations whose principal business is the lending of money.

It is proposed that this measure apply as of July 1, 2000, in respect of indebtedness incurred after February 27, 2000. This will allow interested parties an opportunity to comment on the proposal.

Example

- Assume that Canco would have to pay interest at 8% on a 2-year Canadian dollar (C$) loan, while it would pay 13% on a 2-year Country F dollar (F$) loan.
- As Canco needs C$1m for use in its business, it borrows F$2m in 2001 and immediately converts the borrowed money into C$1m.
- Canco makes the following payments under the loan:

Payment	F$ value	Exchange rate	C$ value
		(all amounts in 000s)	
Interest – 2002	F$260	0.4779	C$124
Interest – 2003	F$260	0.4567	C$119
Principal – 2003	F$2,000	0.4567	C$913

- Canco realizes a foreign exchange gain when it repays the debt in depreciated F$:

Value of principal on borrowing:	C$1,000
Value of principal on repayment:	C$913
Foreign exchange gain:	C$87

Proposed Tax Treatment

- Since Canco could have borrowed the C$ equivalent of F$2m (C$1m) on the same terms for 8%, Canco's annual interest deduction is limited to 8% of C$1m, i.e., $80,000:

Year	Interest paid	Deductible	Not deductible in year
		(all amounts in 000s)	
2002	C$124	C$80	C$44
2003	C$119	C$80	C$39
Total	C$243	C$160	C$83

- The amount of the non-deductible interest is aggregated over the term of the loan and deducted in computing the foreign exchange gain realized on repayment of the loan. The resulting gain is treated on income account:

Foreign exchange gain:	C$87
Undeducted interest:	C$83
Adjusted foreign exchange gain (loss):	C$4

Example *(cont'd)*

- The application of the rule does not fully eliminate the exchange gain. This is because the rule takes the simplifying approach of allowing an interest deduction over the term of the loan at a fixed percentage (8 per cent) of the original C$ value of the principal. A more accurate – but more complex – approach would treat the non-deductible interest paid each year as a prepayment of principal. Such an approach would only allow an interest deduction in subsequent years for the fixed percentage of the reduced principal – effectively disallowing more interest over the term of the loan than under the proposed rule.

Government Assistance for Scientific Research and Experimental Development

Various levels of government provide both tax and non-tax assistance to taxpayers in order to achieve a variety of policy objectives. Tax assistance includes investment tax credits (ITCs) and super-deductions (i.e., deductions over 100 per cent of cost). Non-tax assistance includes grants and conditionally repayable contributions. The combined level of assistance can be overly generous with a resultant misallocation of resources.

One of the ways that this misallocation is avoided is to base the cost of the expenditure for federal ITC purposes on the cost of the eligible investment net of any other government assistance or reimbursement that the taxpayer has received or is entitled to receive. This ensures that the ITC is based on the taxpayer's actual costs.

However, not all types of government assistance are treated equally for income tax purposes. Deductions in excess of 100 per cent, commonly known as "super-deductions," are provided in certain provinces. These super-deductions are not considered to be government assistance and thus do not affect the expenditure base for federal ITC purposes, even though they are similar in many respects to provincial ITCs.

To address this issue, the budget proposes to treat provincial deductions for scientific research and experimental development (SR&ED) that exceed the actual amount of the expenditure as government assistance for taxation years ending after February 2000. If a corporation is eligible for SR&ED ITCs at

the enhanced rate of 35 per cent (i.e., it is a small Canadian-controlled private corporation), the value of the assistance will be determined at the relevant provincial small business corporate income tax rate that is applicable in that province multiplied by the amount by which the deduction for provincial income tax purposes exceeds the actual amount of the expenditure. For all other corporations, the value of the assistance will be determined as the maximum provincial corporate income tax rate applicable to active business income multiplied by the amount by which the deduction for provincial income tax purposes exceeds the actual amount of the expenditure.

This change will result in SR&ED deductions and credits having comparable value, reduce stacking of benefits and make the tax system fairer.

Foreign Tax Credit and Oil and Gas Production Sharing Agreements

To limit the impact of the application of Canadian and foreign taxes on the same income, Canada provides its residents with "foreign tax credits" for income or profits taxes they have paid to another country. In most cases, it is clear whether a foreign tax is sufficiently similar to Canada's income tax to qualify for these credits. However, the characterization of a levy as an income tax is less clear with respect to certain levies imposed in some oil- and gas-producing countries.

The levies in question are imposed under "production sharing agreements" between the governments of the countries concerned (or their agents) and Canadian-resident companies. Under a typical production sharing agreement, the company undertakes to conduct exploration activities within a defined territory and, where the exploration efforts are successful, to develop the resource property and exploit it commercially. At the commercial exploitation stage, the resource production is divided between the company and the foreign government, often through a state-owned corporation, according to a sharing formula agreed to in the contract. Such formulas, which vary from contract to contract, typically grant the company enough of the resource production to cover its costs and to generate a profit. Production sharing agreements generally set out in detail how costs are to be recovered over time, what proportion of the production must be allocated to the state in any given year, and other key terms.

Most of the countries that enter into such agreements with Canadian companies also impose a corporate income tax. Rather than applying the tax separately, however, these countries integrate their income tax into the production sharing agreements themselves. In effect, part of the foreign government's share of the production under the agreement is characterized as a payment in satisfaction of the Canadian company's income tax liability to that government.

Because a production sharing agreement both allocates oil and gas production and incorporates the foreign country's income tax, it can be difficult to determine which portion of the foreign government's share is on account of an income tax. Indeed, the Income Tax Act's current foreign tax credit rules may deny credit for any and all payments made pursuant to such agreements. The uncertainty Canadian companies face as a result can put them at a disadvantage relative to those foreign competitors whose domestic taxation rules provide foreign tax credits in similar circumstances.

The budget proposes to introduce amendments to the Income Tax Act that will clarify the eligibility for a business foreign tax credit of certain payments made by Canadian resident taxpayers to foreign governments on account of levies imposed in connection with production sharing agreements. The proposed amendments will set out those circumstances in which a levy will be considered to be, in substance, an income tax paid by a taxpayer.

More specifically, the proposed amendments will require that, for a foreign levy to qualify, it must be computed by reference to net income, after recognition of relevant expenses, and must not be, under the agreement, either a royalty or any other consideration paid for the exploitation of the resource. Because the amendments are intended to accommodate situations where the foreign income tax is calculated pursuant to a production sharing agreement, as opposed to being assessed separately, the proposed rules will apply only where the foreign country otherwise imposes what can be regarded as an income tax.

The amount eligible for a foreign tax credit cannot, under the proposal, exceed 40 per cent of the taxpayer's income from the business for the year and will be subject to the existing rules of the Act governing the claiming of business foreign tax credits and the carry-overs of unused credits. The 40 per cent rate is an approximation of the Canadian corporate rate and is the same proxy rate currently used for other foreign tax credit purposes.

The amendments to the business foreign tax credit provisions of the Act will also include specific rules for the recognition of a taxpayer's foreign exploration and development expenses (FEDE), discussed in the next section. While there already exists a general requirement in the Act for taxpayers to recognize FEDE in computing the amount of foreign tax credit that can be claimed in respect of foreign source income, these rules will specify how FEDE will be allocated to a particular foreign country for purposes of claiming a foreign tax credit.

The new rules will apply for foreign income taxes paid by any given taxpayer, pursuant to production sharing agreements, in taxation years that begin after the earlier of December 31, 1999, and a date chosen by the taxpayer (which date cannot in any case be earlier than December 31, 1994).

Foreign Exploration and Development Expenses

A Canadian oil and gas or mining company that incurs foreign exploration and development expenses (FEDE) may claim a minimum 10 per cent of its FEDE balance against its income from any source. A greater claim is permitted if a taxpayer's foreign resource income exceeds the 10-per-cent minimum.

Issues

The existing regime for FEDE raises a number of concerns.

First, there is no explicit requirement under the existing rules that FEDE be incurred by a taxpayer for the purpose of entitling the taxpayer to profits or gains in respect of any foreign resource property of the taxpayer. For example, some taxpayers have claimed FEDE even though a foreign affiliate of the taxpayer owns the foreign resource property to which the FEDE relates.

In addition, there are circumstances where FEDE expenses have been generated by virtue of a taxpayer resident in Canada acquiring resource property of little value from a debtor of the taxpayer in circumstances to which section 79.1 of the Income Tax Act applies. The general effect of section 79.1 is that a creditor acquires property seized from a debtor in default of a payment of a debt at a cost equal to the principal amount of the debt, but is not entitled to claim a capital loss or bad debt expense with regard to that debt. The application of section 79.1 in this context is a particular concern where the debtor is not resident in Canada. This is because

the parallel rules in section 79, under which the debtor is generally deemed to have proceeds of disposition from the resource property equal to the principal amount of the debt, will not have any effect on the debtor's Canadian income tax.

Second, existing FEDE rules allow taxpayers to claim a FEDE deduction of up to the full amount of foreign resource income earned. In this respect, the FEDE rules are more generous than the rules permitting the deduction of Canadian development expenses and Canadian oil and gas property expenses. The FEDE rules also result in similar treatment for foreign exploration expenses as compared to Canadian exploration expenses, even though the 100-per-cent write-off is an accelerated incentive rate designed to encourage exploration activities in Canada.

Third, existing FEDE rules do not expressly apply on a country-by-country basis. Thus, it is difficult to source FEDE deductions to a particular country in cases where a taxpayer incurs FEDE in connection with more than one country outside Canada. This issue is of particular significance with regard to the calculation of a taxpayer's entitlement to foreign tax credits pursuant to the proposed new rules for production sharing agreements.

Also, the discretionary nature of the FEDE deduction may provide overly generous opportunities for maximizing foreign tax credit claims. This is because a FEDE deduction might be claimed in a taxation year for which little or no foreign business income taxes are paid, and not claimed in a taxation year for which large amounts of foreign business income taxes are paid. This action might be taken either to minimize the impact of the proposed 40-per-cent limit with regard to production sharing agreements, or to minimize the effect of income-based restrictions in the existing foreign tax credit rules.

Proposals

The budget proposes to introduce amendments to address all of these concerns.

Proposed Restrictions on FEDE Definition

With regard to outlays made by a person or partnership after February 27, 2000 (other than any outlay made pursuant to an agreement in writing entered into before February 28, 2000), FEDE must

- relate to the acquisition of foreign resource property by the person or partnership, or
- be made for the purpose of enhancing the value of foreign resource property owned or to be owned by the person or partnership.

Consistent with this new measure, section 79.1 will not apply in connection with foreign resource property acquired after February 27, 2000, from a person (other than a person resident in Canada) or a partnership (other than a partnership each member of which is resident in Canada). These measures are aimed at ensuring that FEDE incurred by a taxpayer has the potential of directly generating income for the taxpayer that is subject to tax in Canada.

Proposed Restrictions on Claiming of Post-2000 FEDE

Post-2000 FEDE expenses will be allocated to separate pools on a country-by-country basis. Foreign resource income will be applied first to support global FEDE claims (i.e., FEDE claims generated under existing rules) and then, subject to a new limit equal to 30 per cent of the FEDE balance in respect of a country, to support FEDE deductions in respect of the country to which the income relates. However, to the extent that the country-by-country limitation would cause a taxpayer's overall maximum FEDE deductions for a taxation year to be less than 30 per cent of total FEDE balances, the taxpayer will be permitted to augment the portion of a FEDE balance for a taxation year that may be claimed. The augmentations to FEDE deductions for specific countries in these circumstances will be structured so that a taxpayer will be allowed in aggregate to claim FEDE deductions for a taxation year totalling not more than the lesser of

- 30 per cent of the total FEDE balances, and
- the taxpayer's total foreign resource income for the year.

It is proposed to provide taxpayers with maximum flexibility as to which FEDE balance a deduction is claimed against. This is consistent with the approach taken with regard to the undepreciated capital cost of depreciable property. However, it is only after

determining the amount of deduction against an FEDE balance generated by pre-2001 expenses that it will be possible to determine deductions against FEDE balances generated by post-2000 expenses.

The new 30-per-cent restriction for new FEDE balances necessitates consequential changes to the successor rules for foreign resource properties in section 66.7 of the Income Tax Act.

All of these measures apply to taxation years that begin after 2000.

Taxpayers Ceasing to Reside in Canada

Consistent with the proposed approach for the treatment of post-2000 FEDE, the budget proposes that the FEDE deduction that a taxpayer who ceases to reside in Canada may claim be limited to the taxpayer's foreign resource income (including foreign resource income arising from the deemed disposition of foreign resource property on the taxpayer ceasing to reside in Canada). However, the taxpayer will be permitted to deduct annually up to 10 per cent of the taxpayer's FEDE balance while non-resident against taxable income earned in Canada while a non-resident.

This measure will apply to taxpayers who cease to reside in Canada after February 27, 2000.

Allocation of FEDE for Foreign Tax Credit and Other Purposes

An FEDE deduction claimed for a taxation year that begins after December 31, 1999 (or after such earlier date as the taxpayer has elected to have the new production sharing agreement rules apply), will be explicitly required to be allocated to a specific country where the FEDE deduction relates to a pre-2001 FEDE balance. This rule is intended to apply primarily for the purpose of computing a taxpayer's foreign tax credit.

A taxpayer will be permitted to make reasonable assumptions as to which country or countries a particular deduction from a pre-2001 FEDE balance relates, provided that those assumptions apply consistently from year to year. If a taxpayer fails to make reasonable assumptions in this regard, the Minister of National Revenue will make reasonable assumptions that will be binding on the taxpayer.

It will be assumed for the purpose of the foreign tax credit calculation that a taxpayer's FEDE deduction for a taxation year in respect of a country is generally the greater of

- the taxpayer's FEDE deduction for the year, and
- the maximum FEDE deduction for the year that the taxpayer could claim if the augmentation of FEDE deductions (as described above in *Proposed Restrictions on Claiming of Post-2000 FEDE*) were not taken into account.

Manufacturing and Processing Tax Rate Reduction Extended to Income from Sale of Steam

Since 1973, the Government has provided a tax credit to reduce the rate of corporate tax applicable to Canadian manufacturing and processing profits. Before the February 16, 1999, budget, the definition of manufacturing and processing (M&P) had specifically excluded the production or processing of electrical energy or steam for sale. That budget proposed the extension of the M&P tax credit to corporations that produce, for sale, electrical energy or steam used in the generation of electricity.

This budget proposes to extend the M&P tax credit to corporations that produce, for sale, steam for uses other than the generation of electricity. This change will ensure that all producers of steam for sale will face the same income tax rate. Access to the credit will be phased in beginning January 1, 2000, with a three-percentage-point reduction. In each of the two subsequent years, there will be additional two-percentage-point reductions. The phase-in to M&P treatment will be completed in 2002. These proposed rate reductions will be prorated for taxation years that straddle calendar years.

Adjustments to the Capital Cost Allowance System

A portion of the capital cost of depreciable property is deductible as capital cost allowance (CCA) each year. The maximum CCA rate for each type of property is set out in the Income Tax Regulations. The Government attempts to ensure that these CCA rates reflect, as closely as possible, the useful lives of the assets.

Various factors affect the useful lives of capital assets, including technological obsolescence and changing market conditions. The CCA regime is reviewed on an ongoing basis to ensure that the CCA

rates are appropriate and do not impede the ability of Canadian firms to invest and compete.

As a result of this review, the budget proposes several adjustments to improve the CCA system. Proposed changes include

- an increase in the CCA rate for certain rail assets;
- an extension of the separate class election to include manufacturing and processing equipment; and
- an increase in the CCA rates for certain electrical generating equipment, and for production and distribution equipment of a distributor of water or heat.

Rail Assets

Most rail assets owned by common carriers, including railway cars and locomotives, are currently eligible for a 10-per-cent CCA rate.

Current CCA Treatment

Class 6 and Class 35 of Schedule II to the Income Tax Regulations include:

- locomotives described in paragraph (*j*) of Class 6 as "a railway locomotive acquired after May 25, 1976, but not including an automotive railway car";
- railway cars described in paragraph (*a*) of Class 35 as "a railway car acquired after May 25, 1976"; and
- rail suspension devices described in paragraph (*b*) of Class 35 as "a rail suspension device designed to carry trailers that are designed to be hauled on both highways and railway tracks."

The budget proposes that the CCA rates for such locomotives, railway cars and rail suspension devices acquired after February 27, 2000, be increased to 15 per cent. This rate will better reflect the estimated useful life of these assets.

In certain instances, Class 35 railway assets that are the subject of a lease are already eligible for a 13-per-cent CCA rate. The proposed 15-per-cent CCA rate will apply to these assets only if the lessor elects to have the "specified leasing property" rules apply to the asset.

Separate Class Election for Manufacturing and Processing Equipment

In general, the CCA system groups properties into a limited number of broad classes with specified depreciation rates that apply on a diminishing balance basis. In most cases, this system works well and is simple to administer. The use of a class system provides, on average, deductions for tax purposes that reflect the useful life of the property. However, the rate at which any particular piece of equipment depreciates can vary significantly depending on how it is used and the progress of technological change. In some circumstances, the CCA system does not adequately reflect variations in depreciation experience resulting from technological change. In response to this, the 1993 budget introduced a separate class election for computer equipment and certain types of office communication and electronic equipment.

The separate class election allows taxpayers to place eligible property in a separate class for CCA purposes. Although the separate class election does not change the specified CCA rate, it ensures that, upon the disposition of all the property in the class, any remaining undepreciated balance can be fully deducted as a terminal loss.

The useful life of manufacturing equipment can vary widely. To address situations where certain types of equipment have an unusually short economic life, the budget proposes that the separate class election be extended to include manufacturing and processing property included in Class 43 of Schedule II to the Income Tax Regulations costing more than $1,000. This measure will apply to property acquired after February 27, 2000. The proposed election must be filed with the income tax return for the taxation year in which the property is acquired.

As with the 1993 provision, the undepreciated capital cost (UCC) in each separate class created pursuant to this measure, that is remaining after five years, must be transferred into the general Class 43 UCC pool.

Electrical Generating Equipment, and Heat or Water Production and Distribution Equipment

Currently, the electrical generating equipment of a producer of electrical energy is generally eligible for a 4-per-cent CCA rate under Class 1 of Schedule II to the Income Tax Regulations. The production and distribution equipment of a distributor of heat or water are also generally eligible for this rate under Class 1.

Current CCA Treatment

Class 1 of Schedule II to the Income Tax Regulations includes:

- electrical generating equipment described in paragraph (*k*), or described in paragraph (*m*) as "generating or distributing equipment and plant (including structures) of a producer or distributor of electrical energy"; and
- production and distribution equipment described in paragraphs (*o*) as "distributing equipment and plant (including structures) of a distributor of water" or (*p*) as "production and distributing equipment and plant (including structures) of a distributor of heat."

Industry consultations have established that this rate no longer reflects the estimated useful life of such equipment. The budget proposes that the CCA rate be increased from 4 per cent to 8 per cent for the following equipment currently included in Class 1:

- electrical generating equipment (other than buildings and other structures),
- production and distribution equipment (other than buildings and other structures) of a producer or distributor of heat, and
- distribution equipment (other than buildings and other structures) for a distributor of water (other than for consumption, disposal or treatment).

The 8-per-cent rate will apply to equipment acquired after February 27, 2000, that has not been used or acquired for use prior to that date.

It is further proposed that combustion turbines that generate electricity (and any associated burners and compressors) be eligible for a separate class election. The general rule which would otherwise require the property to be transferred into the general UCC pool after five years will not apply.

The separate class election will only apply to equipment acquired after February 27, 2000, that has not been used or acquired for use prior to that date. The proposed election must be filed with the income tax return for the taxation year in which the property is acquired.

Capital Tax Surcharge on Large Deposit-Taking Institutions

The budget proposes that the capital tax surcharge on large deposit-taking institutions, which was introduced in the 1995 budget, and extended in subsequent budgets, will be further extended to October 31, 2001. As announced by the Government in its June 25, 1999, paper *Reforming Canada's Financial Services Sector*, a review of the application of this surcharge is, however, underway and the results will be announced when the financial sector review legislation is tabled.

This surcharge applies to financial institutions as defined under Part VI of the Income Tax Act except life insurance companies. The surcharge will continue to apply at a rate of 12 per cent of the capital tax imposed under Part VI, calculated before any credit for income taxes and with a capital deduction of $400 million. The surcharge is not eligible to be offset by tax payable under Part I of the Act.

The surcharge will be prorated for taxation years that straddle October 31, 2001.

Goods and Services Tax/ Harmonized Sales Tax Changes

Export Distribution Centre Program

The budget proposes a new regime for export distribution centres.

The GST/HST is a tax on the final consumption of goods and services in Canada. Thus, a key objective of the tax is to fully relieve exported goods and services from the tax. Under the GST/HST system, where an exporter purchases or imports goods, processes them and exports the finished product, the exporter must pay tax on its purchases and importations, which it subsequently recovers through the input tax credit mechanism. While this process involves a financing cost, since unlike most other businesses exporters do not

obtain a cash-flow benefit from collecting GST/HST on their sales, it has proven to be the most effective mechanism of ensuring that exports are fully relieved of tax. Alternative approaches, such as single-stage sales taxes, which involve the universal use of exemption certificates, typically result in tax being built into the cost of exports.

However, in cases where there is limited processing in Canada, the cash-flow cost may be significant in relation to the level of value added to goods by the business. Existing measures in the GST/HST that help alleviate this cash-flow cost, such as the Export Trading House Program and the Customs Bonded Warehouse Program, are targeted to particular types of activity, but in some cases do not extend to distribution activities. The budget proposes to address cash-flow issues relating to these activities through legislative amendments and administrative streamlining of existing programs to ensure that cash-flow implications do not preclude Canada as a location for North American distribution centres. The measures proposed in this budget are designed to address this issue in a targeted manner, without threatening the effectiveness of the multi-stage GST/HST system.

The budget proposes a new export distribution centre program that will permit businesses that export substantially all of their outputs, or operate export distribution operations for other businesses, to acquire or import most goods without the payment of GST/HST. This program will be targeted at businesses that provide limited value added in the course of processing goods.

The budget proposes that the legislative proposals regarding the Export Distribution Centre Program come into force on January 1, 2001, so as to allow for consultations this spring.

In addition, a number of legislative enhancements are proposed to:

- broaden the rules that provide for the tax-free importation of goods for warranty repair;
- enhance the “drop-shipment” rules;
- expand the Exporters of Processing Services Program; and
- parallel aspects of the proposed Export Distribution Centre Program in the existing Export Trading House Program.

Finally, the Canada Customs and Revenue Agency (CCRA) will be streamlining administration of some of its processes relating to existing import/export programs.

Export Distribution Centre Program

The budget proposes a new Export Distribution Centre Program that will relieve the cash-flow burden resulting from the imposition of the GST/HST for eligible businesses that acquire or import goods on which they perform limited or no processing before export.

For the purposes of the Export Distribution Centre Program, eligible businesses will be those:

- whose export revenue accounts for at least 90 per cent of their total revenue generated from activities in Canada; and
- that add only limited value to goods.

The export revenue threshold is intended to target the new program at export-orientated businesses. For this purpose, export revenue will include both revenue from the sale of goods to be exported and revenue from the provision of services in respect of other persons' goods that are to be exported.

In addition, since the proposal is intended to address cash-flow problems that exist where limited value-added processing takes place in relation to turnover, there will be defined limits on value added. For those businesses that process their own goods before export, the limit will require that the direct labour content of the cost of the goods supplied by the business not exceed a prescribed percentage. With respect to customers' goods, a test will apply to ensure that the value of the services provided in respect of those goods does not exceed a prescribed percentage of the total value of those services plus the value of the goods when imported or transferred to the business. In both instances, activities that can presently be undertaken in a customs bonded warehouse will be excluded from the calculation. These prescribed percentages will be determined after consultations on the proposal.

Qualifying businesses will be able to use a certificate to acquire or import on a tax-free basis inventory or parts or components to be used in processing, and to import goods in respect of which processing, storage or distribution services will be performed. However, in order to mitigate the compliance burden on domestic suppliers, relief will not be available for single domestic transactions totalling less than $1,000. Where the export distribution centre is not able to use the certificate (e.g., in respect of soft costs such as rent), the existing GST/HST rules will continue to apply with respect to paying the GST/HST and claiming input tax credits.

The export-revenue test and the value-added test will be applied on an annual basis at the end of the export distribution centre's fiscal year. Where these tests are not satisfied, or there has been improper use of the certificate, the export distribution centre will be required to make adjustments to its net tax to ensure that no cash-flow benefits are realized from having utilized the certificate. As well, falling short of the export-revenue threshold by more than 10 percentage points or the failure to meet the value-added test will result in the revocation of the authorization to use the certificate.

To complement the Export Distribution Centre Program, the budget proposes that several existing measures dealing with the importation and exportation of goods and services be enhanced and refined.

Non-Taxable Importations

Relief from tax on importation is currently granted to goods imported into Canada for warranty repair provided the goods are exported after the service is performed. However, where the imported good is replaced rather than repaired, relief from tax on importation does not apply. The budget proposes to extend the relieving rules to cover situations where a replacement good is provided under warranty and is exported in place of the original imported defective good (e.g., where the original good is destroyed). The amendment is proposed to apply to goods imported after February 28, 2000.

Drop Shipments

The purpose of the drop-shipment rules under the GST/HST system is to allow an unregistered non-resident person to acquire goods and most services in respect of goods in Canada, without paying GST/HST, where the goods are bound for export and remain in the possession of registered Canadian service providers before being exported. The budget proposes the following amendments in order to ensure that this objective is met.

The drop-shipment rules allow an unregistered non-resident person to acquire most services in respect of goods in Canada without paying GST/HST, provided that all other conditions are satisfied. At present, the service of storing goods is not covered by these rules. The budget proposes to include storage services among those services that can be provided tax-free under these rules. This amendment is proposed to apply to supplies of services for which tax becomes payable after February 28, 2000.

The drop-shipment rules will also be amended to take into account current industry practice with respect to sales of railway rolling stock. Under the current GST/HST rules, a sale of railway rolling stock to an unregistered non-resident person is tax-free only if it is not used in Canada after delivery and prior to export. This means, for example, that a railway car must be shipped empty to its foreign destination. These rules are not consistent with industry practice. The budget proposes to amend the drop-shipment rules so that the use of railway rolling stock in the course of its exportation will not disqualify it from tax-free treatment, provided that the rolling stock is exported within 60 days after delivery to the non-resident. This amendment is proposed to apply to sales for which tax becomes payable after February 28, 2000.

Exporters of Processing Services Program

The Exporters of Processing Services Program allows the tax-free importation of goods by a Canadian processor for the purpose of processing the goods in Canada and subsequent export if, throughout the time the goods remain in Canada, they are not the property of the processor or a non-resident person to whom the processor is closely related. However, the program does not apply where a Canadian processor only provides storage or distribution services. The budget proposes to expand the program to allow storage and distribution activities. The amendment is proposed to apply to goods imported after February 28, 2000.

Export Trading House Program

The budget proposes changes to the Export Trading House Program to align the rules with the proposed Export Distribution Centre Program. The Export Trading House Program relieves GST/HST on domestic goods purchased by businesses that are exporters where at least 90 per cent of their domestic inventory purchases, and 90 per cent of their revenue from sales of inventory, relates to goods that are exported without further processing in Canada. To ensure consistency between the two programs, the following changes will be made to the Export Trading House Program:

- an export trading house will be able to request that its authorization to use an export trading house certificate be revoked; and

- upon revocation of its authorization (other than a voluntary revocation), or where there has been improper use of the certificate, an export trading house will be required to make adjustments to its net tax to ensure that no cash-flow benefits are realized from having utilized the certificate.

The amendments to the Export Trading House Program are proposed to come into force on January 1, 2001.

Administrative Streamlining

Finally, the CCRA will continue to consult with industry members in its review of customs legislation and administration in order to facilitate the importation and exportation of goods under the Duty Deferral Program. These changes will reduce costs and regulatory burden for Duty Deferral Program participants, and expedite the movement of imported goods.

Proposed changes to the Duty Deferral Program include:

- *Improved Single-Window Access for Program Applicants*: Participants will enjoy the benefit of single-window access of the various Duty Deferral Program components. A new application form will also be designed to allow applicants to pick the program options best suited to them.

- *Improved Security Requirements*: Security requirements for the Customs Bonded Warehouse Program will no longer apply to all goods as is currently the case, but will be based on a risk assessment process. This will result in reduced costs for Duty Deferral Program participants.

- *Harmonized Verification Activities*: Verification activities such as customs and GST/HST audits will be revised to ensure consistent and co-ordinated CCRA verification efforts. This will result in less intrusion in company business activities and increased capacity for the CCRA to provide more effective compliance verification activities.

- *Introduction of Operators*: Within the Duties Relief Program, the introduction of operators responsible for a number of participants will enhance client service and reduce paperwork.

New Residential Rental Property Rebate

The budget proposes a rebate program for new residential rental accommodation.

Under the existing federal sales tax system, tax applies to new residential rental property when the property is acquired by a landlord from a builder, or, on a self-assessed basis, when the builder is the landlord. For purchaser-landlords, the tax becomes payable upon purchase of the residential complex. For builder-landlords, the tax becomes payable as soon as the first unit in the residential complex is rented. As a result, both purchaser-landlords and builder-landlords finance the tax liability up front and recover the tax over time.

The budget proposes to introduce a New Residential Rental Property Rebate, equal to 2.5 percentage points of tax, for newly-constructed, substantially-renovated or converted residential rental accommodation, payable to the person who paid the tax. This rebate will apply in respect of such property used for long-term rental accommodation. It will also apply to the construction of additions to residential rental property and to the leasing of land that is used for residential purposes. The rebate will apply to construction, substantial renovation or conversions commencing after February 27, 2000. In the case of leased land, the rebate will apply where the lease agreement is entered into after February 27, 2000.

In order to target the rebate to those who provide long-term residential accommodation, the concept of a "qualifying residential unit" will be used. A residential unit is a "qualifying residential unit" if it is a self-contained residence and if it can reasonably be expected that the first use of the unit will be for the purpose of renting it for periods of continuous occupancy of at least 12 months as a primary place of residence, under one or more leases. Generally, a "self-contained residence" refers to a residential unit that contains a private kitchen, bath and living area.

In general, a unit-by-unit test will be used to determine which residential units in a multiple unit residential complex, such as an apartment building, will qualify for the rebate. However, to simplify matters in the case of large multiple-unit residential complexes, the entire complex will be considered to meet the expected 12-month occupancy test if substantially all of the units meet that test.

The full rebate will be available for rental units valued up to $350,000. For rental units valued between $350,000 and $450,000, the rebate will be gradually phased out. No rebate will be available for rental units valued at $450,000 or more. A similar regime will apply in the case of land that is leased for residential purposes. In the case of leased residential land, the rebate thresholds will be reduced proportionately to reflect the fact that the rebate applies only in respect of the land as opposed to the land and building.

Persons eligible for the New Residential Rental Property Rebate will be landlords who have paid tax on the purchase of a new residential rental property or builder-landlords who must self-assess tax where they have built a new residential rental property or an addition to a multiple-unit rental complex. Persons who are entitled to claim input tax credits in respect of that tax will not be eligible for the New Residential Rental Property Rebate. Generally, the same will be true for persons who are entitled to claim other rebates in respect of the property such as the Public Service Body Rebate or the New Housing Rebate.

Duplexes

Currently, new duplexes qualify for the existing New Housing Rebate where the property is used as the primary place of residence of the purchaser or a relation of the purchaser. Under the budget proposal, where the duplex is rented out, it will qualify for the New Residential Rental Property Rebate. That qualification is contingent on at least one of the two residential units which form the duplex meeting the definition of a "qualifying residential unit". If that condition is met, the New Residential Rental Property Rebate will be available in respect of the duplex and will be determined in the same manner as for a single detached house. The thresholds and the phase-out will apply to the value of the entire duplex as is currently the case under the New Housing Rebate Program.

Co-operative Housing

Where a co-operative housing corporation has paid tax in respect of a residential complex of the corporation and sells a share that gives a right to the purchaser to occupy a new residential unit in the complex, the purchaser is currently entitled to claim the New Housing Rebate as long as the unit is for use as the primary place of residence of the purchaser or a relation of the purchaser. The budget proposes that the corporation be entitled to the New Residential Rental Property Rebate where the unit is a qualifying residential unit. However, that rebate will be reduced by the amount

of the New Housing Rebate to which the purchaser is entitled. Further, the budget proposes that where a new qualifying residential unit is first occupied by an individual other than a purchaser of a share of a corporation or a relation of such a purchaser, the corporation will be entitled to the full New Residential Rental Property Rebate for that unit. As is the case currently, there will be no New Housing Rebate available to the individual in that circumstance.

Temporary Rentals Before Sale

The budget proposes that the builder or landlord of a new qualifying residential unit be entitled to the New Residential Rental Property Rebate where the unit is first leased to an individual as a primary place of residence, notwithstanding that the builder or landlord, as the case may be, intends to sell the unit at the earliest opportunity.

The amount of the rebate plus interest will be subject to recapture where the unit is sold within one year from the time it is first occupied, to a purchaser who is not acquiring it for use as the primary place of residence of the purchaser or a relation of the purchaser.

Land Leased for Residential Purposes

Currently, landowners who lease land to tenants for residential use must self-assess tax at the time of first lease. The lease to the tenant is exempt from sales tax. Therefore, the lessor finances the tax liability up front and recovers those costs over time through rental receipts. The budget proposes that lessors be eligible for the New Residential Rental Property Rebate in the following circumstances:

- Lease of Land: Where an individual leases land on which the individual intends to construct or affix a residential complex, the individual is currently eligible for the New Housing Rebate in respect of tax paid on inputs used to construct or affix the residential complex. The landowner, in turn, is required to self-assess tax on the value of the land. No rebate is currently payable to the landowner. The budget proposes that the landowner (lessor) be eligible for the New Residential Rental Property Rebate provided that the residential complex is for use as the primary place of residence of the individual or a relation of the individual. The full rental rebate will be available for land valued up to $87,500. For land valued between $87,500 and $112,500, the rebate will be gradually phased out, with no rebate available for land valued at $112,500 or more.

- *Lease of Land, Sale of Building:* Where a builder leases land on which the builder constructs a residence that is sold, the homebuyer is generally eligible for the New Housing Rebate on the value of the residence and no rebate is available in respect of the land. The budget proposes that the builder be entitled to the New Residential Rental Property Rebate in respect of the land. The same thresholds will apply as in the case where both the land and building are leased.
- *New Residential Trailer Parks:* An operator of a residential trailer park is currently required to self-assess tax on the fair market value of the entire park or an addition to the park when first supplying a site in the park or the addition. The budget proposes that the operator be entitled to the New Residential Rental Property Rebate in these circumstances. The thresholds applicable to the leasing of land will apply in respect of each site in the new trailer park or addition. This rebate will apply to new residential trailer parks or additions where the first site in the park or the addition is leased after February 27, 2000.

Administration of the Rebate

Rebate claimants other than co-operative housing corporations will have up to two years from the end of the month in which the related tax becomes payable to claim the New Residential Rental Property Rebate in respect of the tax. In the case of a residential unit leased by a co-operative housing corporation, the corporation will have up to two years from the end of the month in which the lease agreement was entered into to claim the rebate in respect of that unit. However, in both cases, where the end of that month is before the day on which the implementing legislation receives Royal Assent, a transitional rule will ensure that eligible claimants have a full two years from that day to claim the rebate.

Jeopardy Assessment and Collection

There are circumstances wherein the Minister of National Revenue must take immediate collection action in order to preserve the tax base and ensure that evasion practices are not successful. The budget proposes an additional measure to ensure that the Minister is able to take timely action to protect revenues in those circumstances.

Under the GST/HST, registered businesses must file a return and remit tax collected from customers, after deducting any input tax credits to which they may be entitled, after each of their reporting periods. Monthly and quarterly filers have one month

following the end of their reporting period to file their return and remit any net tax payable. Annual filers generally have until the end of the third month, and, in some cases, the end of the fourth month, following their fiscal year to remit tax collected throughout the year. This means, for example, that tax collected by an annual filer from a customer in the first month of the registrant's calendar year might not have to be remitted for another 15 months.

There is a high degree of voluntary compliance with these reporting and remittance requirements amongst GST/HST registrants. However, instances can arise where allowing a registrant the usual period for the remittance of tax would put those tax revenues at risk. In such cases, the Minister of National Revenue currently has the authority to demand that the registrant file a GST/HST return at any time specified in the demand. This authority, however, does not include the power to require the registrant's net tax to be remitted prior to its normal due date. Where the Canada Customs and Revenue Agency (CCRA) has sufficient reason to suspect an intention to evade the payment of tax, it has been powerless to proceed with assessment and collection action.

The budget proposes that the Minister of National Revenue be given authority, on an *ex parte* application to the court, to obtain judicial authorization to assess the amount determined by the Minister to be remittable by a registrant at the time the application is heard and to take actions to recover that amount. Where the court grants the authorization on being satisfied that any delay in issuing an assessment would jeopardize the collection of GST/HST, the CCRA will be permitted to issue the assessment and take immediate collection action.

The requirement for judicial authorization provides the appropriate safeguards to ensure that the exercise of this authority is reasonable and justifiable in the circumstances. In granting the authorization to take immediate action, it will be open to the court to impose any terms and conditions on the exercise of this authority that it considers reasonable. The registrant will have the right to apply for judicial review of the court's decision.

Section 225.2 of the Income Tax Act contains a similar provision relating to the collection of income tax. The procedural rules relating to the proposed new provision in the *Excise Tax Act* correspond to those set out in the existing income tax provision.

This amendment is proposed to come into force on the day on which Royal Assent is given to the implementing legislation.

Other Tax Measures

Scientific Research and Experimental Development

Canada provides one of the most generous tax incentive regimes among industrialized countries for scientific research and experimental development (SR&ED). It is important that this support only benefits those activities to which the program was intended to apply.

In claiming credits for SR&ED (including information technology), three basic criteria must be met:

- scientific or technological uncertainty,
- scientific or technological advancement, and
- scientific or technological content.

Technological advancement is a key element of the program. Technological advancement does not include the application of technology that is merely new to a particular taxpayer or industry. In particular, development work that is routine in nature does not qualify as SR&ED. While the definition of SR&ED was amended in 1985 to include experimental development, consistent with international usage, experimental development does not include projects involving only routine engineering or routine development.

This is reflected in the Canada Customs and Revenue Agency's administrative guidelines for software development, which were developed in consultation with industry.

Nevertheless, the administration of the SR&ED program has come under increasing pressure, particularly in regard to its application to information technology. A disproportionate number of disputes between taxpayers and the Government continue to be in the area of information technology. The Canada Customs and Revenue Agency has been faced with a number of very large and complex claims, many of which are not consistent with its administrative guidelines. These claims are in respect of internal use software, such as management information systems and automated services.

Many of the large claims have been made by corporations whose core business is not software development. CCRA has determined that substantially all of these claims reflect the application of available technology, which result in business improvements but do not embody technological advancement that

the SR&ED program is intended to benefit. The Government is committed to rigorously applying the existing well established three basic criteria to address the backlog of SR&ED claims related to information technology.

In addition, the Government will consult with industry representatives to ensure that the guidelines on software development, in particular internal use software, both reflect government policy and provide clarity and certainty of application for compliance purposes as well as administration. Once consultations are completed, the Government will determine whether amendments to the Income Tax Act are required.

Simplified Film Tax Incentives

The Canadian film and television production industry has achieved considerable expansion in recent years with the support of the federal and provincial governments. Federal support for Canada's film industry includes two tax credits in respect of qualifying labour expenditures:

- the Canadian Film or Video Production Tax Credit (CFVPTC, generally equal to 25 per cent of eligible labour expenses), for film or video productions certified by the Minister of Canadian Heritage as meeting specific Canadian ownership and artistic criteria ; and
- the Film or Video Production Services Tax Credit (FVPSTC, generally equal to 11 per cent of eligible Canadian labour expenses), for other film or video productions produced in Canada.

In some cases, the CFVPTC may be difficult for Canadian film producers to access, particularly where financing arrangements are complex. The Government therefore intends to review the rules respecting the CFVPTC, in consultation with industry associations, to develop criteria for a streamlined mechanism for delivering the CFVPTC incentive. The objective of these discussions is to design criteria that

- result in a simplified calculation for the CFVPTC, based more closely on Canadian labour content;
- reflect the original objectives of the existing eligibility requirements for film and video productions that were announced in the 1995 budget; and
- are revenue-neutral in terms of the level of support to be given by the Government.

Heritage Property

The Government is committed to the development of initiatives in support of the restoration and preservation of Canada's built heritage. Canadian Heritage officials have undertaken discussions with provincial, territorial and municipal government officials with a view to establishing a national register and conservation standards in respect of heritage property. These tools will be instrumental in assessing the necessity of financial support to sustain and ensure the preservation of Canada's built heritage.

First Nations Taxation

In the 1997, 1998 and 1999 budgets, the Government indicated its willingness to put into effect taxation arrangements with interested First Nations. Since that time, Parliament has passed legislation that enables the Cowichan Tribes, the Westbank First Nation, the Kamloops Indian Band and the Sliammon First Nation to levy a tax on sales of certain products on their reserves. In addition, personal income tax collection and sharing agreements with the seven self-governing Yukon First Nations came into effect on January 1, 1999. The Government is once again expressing its willingness to discuss and to put into effect arrangements in respect of direct taxation with interested First Nations.

Provision of Information to Police

Under current law, it is not clear whether taxpayer information can be provided to the police for the purpose of investigating whether the acts of a person against an official of the Canada Customs and Revenue Agency constitute the commission of an offence, unless charges have first been laid or the circumstances constitute imminent personal danger to the official. The Government proposes to amend the confidentiality provisions of the Income Tax Act and the Excise Tax Act to permit an official of the CCRA to provide relevant taxpayer information to the police for the purpose of investigating whether the acts of a person against an official of the CCRA, or against a member of the official's family, constitute an offence under the Criminal Code. In the case of sales tax, the proposed amendment would also apply in respect of a provincial official authorized to exercise duties and powers under Part IX of the Excise Tax Act pursuant to an administration agreement between the government of the province and the Government of Canada.

Administration and Enforcement of the Tax Law

The Income Tax Act and the Excise Tax Act make it an offence to hinder, molest or interfere with an official who is performing certain administrative or enforcement functions. The applicable provisions do not apply in the context of an official who is performing a collection duty, nor do they apply to attempts to hinder. Increasingly, some individuals have taken exceptional measures in an attempt to hinder, harass or delay CCRA officials in the performance of their duties.

The budget proposes to amend the Income Tax Act to extend the penalty applying under subsection 231.5(2) of the Act to persons who hinder, molest or interfere with an official who is performing a collection function, and to persons who attempt to hinder, molest or interfere with an official in the performance of a collection function or any other duty to which that subsection currently applies. Similarly, the budget proposes changes to the Customs Act and the relevant provisions of the Excise Tax Act to parallel the penalty proposed for purposes of the Income Tax Act.

Sharing of Tax Information with Provincial Statistical Agencies

In the past, Statistics Canada has been striving to minimize the high degree of overlap between business survey data collected by Statistics Canada and taxpayer information on businesses collected by the Canada Customs and Revenue Agency. Businesses have expressed concern about the response burden placed on them and the resources required to comply with these requests for information. Since 1997, Statistics Canada has obtained from tax records much of the information previously collected through survey questionnaires. Authority for the release of taxpayer information to Statistics Canada is provided in the Income Tax Act.

When Statistics Canada relied on business surveys conducted jointly by Statistics Canada and the provinces, it applied an authority provided under the Statistics Act to share survey business financial information with provincial statistical agencies – which have the statutory authority to obtain this information by means of their own surveys – for purposes of research and analysis. This data sharing helped to reduce the number of surveys and response costs incurred by businesses in completing these surveys.

However, the rule which allows the sharing of taxpayer information with Statistics Canada does not allow Statistics Canada to share this information with provincial statistical agencies.

To address this issue and to provide continuity of business data for research and analysis by the provinces, the budget proposes to amend the Income Tax Act to allow Statistics Canada to provide taxpayer information in respect of incorporated and unincorporated businesses for the 1997 and subsequent taxation years to provincial statistical agencies solely for use in research and analysis. This amendment will allow provincial needs to be met while keeping the response burden for businesses as low as possible.

The sharing of taxpayer information between federal and provincial statistical agencies will only be permitted once the enabling legislation receives royal assent. Appropriate measures to safeguard the confidentiality of this information will continue to apply. Also, only business-related information can be shared; thus, for unincorporated businesses, information on the business owner which is unrelated to business activities cannot be shared.

Changes to Countervailing Duty Law

In order to bring Canadian countervailing duty laws into line with recent changes to the World Trade Organization (WTO) Agreement on Subsidies and Countervailing Measures, it is necessary to repeal certain provisions in the Special Import Measures Act that prevent the application of countervailing duties against imports benefiting from certain types of foreign subsidies. This action will be taken in concordance with similar actions by Canada's major trading partners so as to ensure reciprocity in the application of WTO subsidy rules.

Reduction in the Tobacco Export Tax Exemption

In 1994, the Government imposed an excise tax on Canadian tobacco exports as part of the National Action Plan to Combat Smuggling. To ensure that Canadian tobacco manufacturers were not denied access to legitimate export markets, several exemptions were provided, including an annual exemption for exports of up to 3 per cent of a manufacturer's production in the preceding year. The 1999 budget proposed that this threshold be reduced to 2.5 per cent.

The budget proposes that the annual exemption from the excise tax on exports be further reduced from 2.5 per cent to 1.5 per cent of the manufacturer's production in the preceding year. There is sufficient latitude in this new threshold, along with other exemptions, to enable tobacco manufacturers to meet legitimate demand for their products outside of Canada, while further reducing the risk of smuggling of tobacco products. The Government will be continuing its monitoring of tobacco exports.

It is proposed that the reduced exemption threshold apply to exports after March 2000.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2000)

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2000)

General Tax Relief

1998

- Increased the amount of income that low-income Canadians can receive on a tax-free basis by $500.
- Eliminated the 3-per-cent general surtax for taxpayers with incomes up to about $50,000 and reduced the amount for those with incomes between $50,000 and $65,000.

1999

- Extended the $500 increase in the amount of income that can be received on a tax-free basis to all Canadians, and increased it for all Canadians by an additional $175, for a total of $675.
- Eliminated the 3-per-cent general surtax for all remaining taxpayers for whom the surtax was not removed in the 1998 budget.

2000

- Proposing to implement actions as outlined in the Five-Year Tax Reduction Plan (implementation date for various measures contained in text) including:
  - Restoring full indexation of the tax system effective January 1, 2000.
  - Reducing the middle tax rate from 26 per cent to 24 per cent.
  - Eliminating the 5 per cent deficit reduction surtax for income up to about $85,000 and reducing the rate to 4 per cent.
- Proposing to reduce capital gains inclusion rate to two-thirds.
- Proposing to permit a rollover of capital gains on the disposition of qualified small business investments.
- Proposing to defer the income inclusion from exercising stock options until disposition.
- Proposing to reduce the general corporate income tax rate to 27 per cent from 28 per cent.
- Proposing to reduce the corporate tax rate on income between $200,000 and $300,000 earned by a CCPC from an active business to 21 per cent from 28 per cent.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2000) (cont'd)

Families and Seniors

1996

- Introduced new tax treatment of child support payments, with payments non-deductible for the payer and non-taxable for the recipient.
- Announced two-step enrichment of the Working Income Supplement (WIS) of the Child Tax Benefit (CTB) of $250 million.
- Replaced the seven-year limit by an unlimited carry-forward of unused registered retirement savings plan (RRSP) room.

1997

- Announced a new Canada Child Tax Benefit (CCTB) by simplifying and enriching the current CTB, starting July 1998, with an $850-million supplement for low-income families.
- Enriched the WIS in July 1997 from the $125 million announced in the 1996 budget to $195 million and restructured from a per-family to a per-child basis.

1998

- Increased the limits to $7,000/$4,000 under the child care expense deduction.
- Enriched the supplement under the CCTB by another $425 million on July 1, 1999 and a further $425 million on July 1, 2000.
- Removed contributions to RRSPs and registered pension plans (RPPs) from the base for the alternative minimum tax.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2000) (cont'd)

Families and Seniors *(cont'd)*

1999

- Set the design for the $850-million increase in the CCTB supplement amount in the 1998 budget.
- Proposed to enrich the CCTB by $300 million in July 2000 to enhance benefits for modest- and middle-income families.
- Proposed to improve the responsiveness of the goods and services tax (GST) credit.
- Proposed to ensure that the maximum GST credit supplement is provided to low-income single-parent families.
- Proposed to allow greater flexibility to transfer RRSP proceeds to financially dependent children upon the death of the RRSP owner.

2000

- Proposing to implement a number of changes to the CCTB:
  - CCTB base benefit to increase by $70 per child July 2000 including indexation.
  - NCB supplement to be increased by $200 per child July 2001 including indexation.
- Proposing to raise the foreign property limit to 25 per cent for 2000 and 30 per cent after 2000.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2000) (cont'd)

Education

1996

- Increased the amount used to establish the education credit from $80 to $100 per month.
- Raised the annual limit on the transfer of the tuition fee and education amounts to those who support students from $4,000 to $5,000.
- Increased the annual limit on contributions to registered education savings plans (RESPs) from $1,500 to $2,000, and the lifetime limit from $31,500 to $42,000.
- Broadened eligibility for the child care expense deduction to assist parents who undertake education or retraining.

1997

- Doubled the amount used to establish the education credit over two years to $200 per month.
- Made ancillary fees, such as health services and athletics, eligible for the tuition credit.
- Allowed a carry-forward of unused tuition and education credits.
- Increased annual contribution limits for RESPs from $2,000 to $4,000.
- Allowed transfers of RESP funds to an RRSP or to the contributor.

1998

- Provided a Canada Education Savings Grant of 20 per cent on annual contributions of up to $2,000, along with carry-forward flexibility.
- Introduced a tax credit for interest on student loans.
- Allowed RRSP withdrawals for lifelong learning.
- Enhanced tax support for part-time education through the education credit and the child care expense deduction.

2000

- Proposing to increase the current partial annual exemption to $3,000 from $500 for scholarship, fellowship or bursary income.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2000) (cont'd)

Tax Assistance for Charities and Public Institutions

1994

- Lowered the threshold at which charitable donations begin to earn the 29-per-cent tax credit from $250 to $200.

1995

- Removed the income limit for tax credits on donations of ecologically sensitive lands.

1996

- Increased the limits on charitable donations eligible for tax credits from 20 per cent to 50 per cent of net income, and to 100 per cent of net income in the year of death and the preceding year.
- Expanded zero-rating of hospital beds to all health care facilities, including long-term care facilities.
- Allowed most charitable and public organizations to raise funds without collecting and remitting GST on sales.
- Extended GST relief on purchases of vehicle modifications necessary to serve individuals with disabilities.
- Provided a 100-per-cent GST rebate on books purchased by public libraries, educational institutions and other specified bodies.

1997

- Reduced the inclusion rate on capital gains arising from the donation of publicly listed securities from 75 per cent to 37.5 per cent.
- Changed the income limit for donations to 75 per cent.
- Included 25 per cent of capital cost allowance (CCA) recapture in the net income limit.
- Sanctioned a new method of valuation for easements of ecologically sensitive lands.
- Increased resources for Revenue Canada to enhance information and compliance from charities.
- Simplified GST accounting, reporting and remittance requirements for charities.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2000) (cont'd)

Tax Assistance for Charities and Public Institutions *(cont'd)*

1998

- Increased tax-free allowances for emergency service volunteers.
- Allowed designated charities to treat certain services they supply to business customers as GST/harmonized sales tax (HST) taxable, thereby allowing charities to compete on an equal footing with other suppliers.
- Provided equivalent GST/HST treatment to charities operating authorized bottle return depots vis-à-vis commercial operators.

2000

- Proposing to reduce tax on employment benefits in respect of donations of shares acquired through stock option plans to parallel treatment for donations of traded securities.
- Proposing to extend the charitable donations tax credit to donations of RRSP, RRIF and insurance proceeds that are made as a consequence of direct beneficiary designations.
- Proposing to reduce capital gains income inclusion by one-half in respect of gifts of ecologically sensitive land and related easements, covenants and servitudes.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2000) (cont'd)

Persons with Disabilities

1996

- Expanded zero-rating of orthopaedic and orthotic devices under the GST.
- Enriched the tax credit for infirm dependants.

1997

- Broadened the medical expense tax credit.
- Removed the limit on the attendant care deduction.
- Introduced a refundable medical expense credit for earners.
- Broadened the definition of preferred beneficiary for trusts benefiting people with disabilities.

1998

- Introduced a new tax credit for caregivers who care for related seniors and persons with disabilities.
- Extended the Home Buyers' Plan to persons with disabilities.
- Included training expenses for caregivers for the medical expense tax credit.
- Allowed certification for the disability tax credit by occupational therapists and psychologists.
- Exempted respite care services from the GST/HST.

1999

- Proposed to expand the medical expense credit to provide enhanced tax assistance for persons with disabilities.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2000) (cont'd)

Persons with Disabilities *(cont'd)*

2000

- Proposing to extend eligibility for the DTC to individuals requiring extensive therapy.
- Proposing to expand list of relatives to whom the DTC can be transferred.
- Providing an increase in credit of up to $500 for families caring for children eligible for the DTC.
- Proposing to increase the maximum child care expense deduction available in respect of persons eligible for the DTC to $10,000 from $7,000.
- Proposing to extend tax assistance for expenses relating to the costs of adapting a new home to the needs of a disabled person.
- Proposing to expand the attendant care deduction to include the cost of an attendant required in order to attend school.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2000) (cont'd)

Personal Income Tax Measures to Better Target Tax Preferences

1994

- Eliminated the $100,000 lifetime capital gains exemption.
- Extended the base for the alternative minimum tax.
- Restricted the use of tax shelters.
- Extended the taxation of employer-paid life insurance premiums to the first $25,000 of coverage.
- Introduced income-testing of the age credit.

1995

- Eliminated tax advantages available through trusts.
- Reduced the overcontribution allowance for RRSPs from $8,000 to $2,000.
- Capped the money purchase RPP and RRSP dollar limits at $13,500 through 2002 and 2003 respectively.
- Eliminated the retiring allowance rollovers for years of service after 1995.
- Eliminated double claims of personal credits in the year of personal bankruptcy.

1996

- Announced new rules on taxpayer migration to ensure that gains that accrue while a taxpayer is a resident of Canada are subject to Canadian tax.
- Capped the maximum pension limit for defined benefit RPPs at $1,722 per year of service until 2005 (only affecting individuals earning over $75,000).
- Reduced the maximum age limit for deferring tax on savings in RRSPs and RPPs from age 71 to 69.
- Further constrained tax shelters relying on a mismatch of income and expenses.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2000) (cont'd)

Personal Income Tax Measures to Better Target Tax Preferences *(cont'd)*

1998

- Allowed deductibility of health and dental premiums for the self-employed.
- Expanded the remote worksite concept.
- Clarified the tax treatment of relocation expenses.
- Strengthened the integrity of the certified cultural property regime.
- Expanded rules regarding employee options to allow the acquisition of units of mutual fund trusts.

1999

- Proposed to prevent income splitting with minors.
- Proposed to address deficiencies in the rules governing the taxation of income earned through investments in foreign-based investment funds and transfers to non-resident trusts.
- Proposed special rules for the treatment of retroactive lump-sum payments.
- Proposed to provide more equitable treatment of income earned by communal organizations.

2000

- Proposing to reduce the federal surtax on income not earned in a province from 52 per cent of basic federal tax to 48 per cent.
- Proposing the $1,000 deemed adjusted cost base and deemed proceeds of disposition for personal-use property not apply if the property is acquired as part of an arrangement in which the property is donated.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2000) (cont'd)

Business Income Tax Measures to Better Target Tax Preferences

1994

- Eliminated, for large private corporations, both the small business deduction and the enhanced scientific research and experimental development (SR&ED) benefits.
- Reduced the deduction for business meals and entertainment expenses from 80 per cent to 50 per cent to better reflect the personal consumption element of these expenditures.
- Increased the rate of tax on corporate dividends received by private investment corporations.
- Implemented measures to ensure that the income of financial institutions is measured appropriately for tax purposes.
- Eliminated the preference for sole-purpose SR&ED performers.
- Reduced regional investment tax credits.
- Modified the basis upon which insurance companies may claim reserves for income tax purposes.
- Ensured corporations cannot avoid paying tax when selling assets through "purchase butterfly" transactions.
- Tightened the rules applicable to foreign affiliates.
- Tightened the rules applicable on forgiveness of debt.

1995

- Increased the large corporations tax (LCT) and corporate surtax.
- Introduced a temporary surcharge on banks and other large deposit-taking institutions.
- Eliminated the deferral of tax on unincorporated business income.
- Eliminated the deferral advantage for investment income earned by private holding companies.
- Replaced the film tax shelter mechanism for certified Canadian films with a tax credit.
- Tightened the rules relating to non-arm's-length contract SR&ED.
- Introduced a voluntary measure for construction industry reporting.
- Tightened the rules concerning superficial losses.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2000) (cont'd)

Business Income Tax Measures to Better Target Tax Preferences *(cont'd)*

1996

- Extended the capital tax surcharge on large deposit-taking institutions.
- Reduced tax assistance for labour sponsored venture capital corporations (LSVCCs).
- Tightened the resource allowance rules.
- Repealed joint exploration corporation rules.
- Restricted eligibility of various expenses for flow-through share treatment.
- Enhanced incentives to invest in renewable energy.
- Limited SR&ED benefits for non-arm's-length salaries and wages.

1997

- Extended the capital tax surcharge on large deposit-taking institutions.
- Replaced tax shelters used to finance non-Canadian films with a tax credit.

1998

- Extended the capital tax surcharge on large deposit-taking institutions.
- Allowed deductibility of countervailing duties and anti-dumping charges.
- Allowed more time for year-end distributions for mutual fund trusts.
- Harmonized financial institution designation for LCT and other purposes.
- Allowed an earthquake reserve deduction.
- Prevented unintended benefits under the SR&ED regime.
- Improved a range of international taxation rules.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2000) (cont'd)

Business Income Tax Measures to Better Target Tax Preferences *(cont'd)*

1999

- Proposed to extend the capital tax surcharge on large deposit-taking institutions.
- Proposed to ensure that electricity generating activities are taxed equitably.
- Proposed to clarify the tax status of non-resident funds that retain Canadian service providers.
- Proposed to update rules governing LSVCCs to ensure consistency with provincial programs, and address issues relating to corporate restructuring.
- Proposed improved capital cost allowances to encourage the productive use of flare gas.

2000

- Proposing to modify the thin capitalization rules so that they work more effectively.
- Proposing to repeal the non-resident-owned investment corporation provisions.
- Proposing to treat provincial deductions for SR&ED that exceed the actual amount of the expenditure as government assistance.
- Proposing to treat weak currency borrowing as equivalent to a direct borrowing in the currency that is used by the taxpayer to earn income.
- Proposing to clarify foreign tax credit rules and rules regarding the deductibility of foreign exploration and development expenses.
- Proposing to extend M&P tax credit to corporations that produce, for sale, steam for uses other than the generation of electricity.
- Proposing adjustments to improve the CCA system for certain rail assets; M&P equipment; and certain electrical generating equipment, and heat/water production and distribution equipment.
- Proposing to further extend to October 31, 2001, the capital tax surcharge on large deposit-taking institutions. A review of the application of this surcharge is however underway and the results will be announced when the financial sector review legislation is tabled.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2000) (cont'd)

Sales Tax Measures to Better Target Tax Preferences

1996–97

- Tightened the GST rules governing the claiming of input tax credits and rebates by large businesses and exempt entities.
- Reinforced the GST rules relating to trusts, estates and partnerships to ensure fair and consistent treatment of similar businesses that are organized differently.
- Refined the criteria for businesses to be treated for GST purposes as being in competition with financial institutions.
- Permitted warranty companies to recover GST paid on reimbursements to warranty holders.
- Extended the GST accommodation rebate for visitors to Canada to non-resident businesses.
- Expanded zero-rating and rebate provisions for exported goods and services.
- Tightened the GST real property rules to ensure that all builders of multiple-unit residential buildings are treated equitably.

1998

- Enhanced the GST/HST Visitor Rebate Program.
- Enhanced the alternate collection mechanism for direct sellers.

1999

- Proposed GST/HST rebate for Multi-Employer Pension Plans to provide comparable sales tax treatment relative to Single-Employer Pension Plans.

2000

- Proposing to introduce a new export distribution centre program to relieve GST/HST cash-flow burden.
- Proposing to introduce a GST rebate, equal to 2.5 percentage points of tax, for newly-constructed, substantially renovated or converted residential rental accommodation not eligible for an existing rebate.
- Proposing to reduce the annual exemption from the excise tax on tobacco exports from 2.5 per cent to 1.5 per cent of production.

Measures to Enhance Tax Fairness and Achieve Economic and Social Objectives (1994-2000) (cont'd)

Simplifying Tax Administration and Improving Enforcement

1994-97

- Strengthened outreach and education programs.
- Enhanced easy-to-understand automatic telephone information systems.
- Met with special taxfiler groups such as senior citizens and immigrants to help them comply.
- Established a single Business Number for streamlining registration for GST remitters, employers, corporations and importers/exporters.
- Introduced a "Business Window" initiative to provide one-stop service for small businesses.
- Simplified payroll reporting for small businesses.
- Reduced compliance costs for small- and medium-sized businesses by co-ordinating GST, income tax and excise tax audits.
- Streamlined procedures to simplify and expedite Customs clearance.
- Implemented a new approach to large business audits including audit protocol.
- Reinforced measures to target the underground economy.
- Proposed earlier identification of abusive tax avoidance and tax shelter schemes.
- Continued to improve sophisticated risk models to identify areas of high risk and a sector approach to compliance for small- and medium-sized businesses.
- Introduced forgiveness of penalties on voluntary tax disclosures to encourage taxpayers to comply voluntarily.
- Included exchange of information provisions to help deal with tax havens.
- Proposed new rules requiring residents of Canada to file an information return when they own foreign assets in excess of $100,000 in value.
- Required adequate documentation of transactions relating to transfer pricing and introduced new penalty provisions related to Revenue Canada reassessments.
- Increased resources for Revenue Canada for transfer pricing audits.

Tax Actions to Date: General Tax Relief and Tax Fairness Measures (1994-2000)

Simplifying Tax Administration and Improving Enforcement *(cont'd)*

1998

- Introduced mandatory reporting of federal and construction contracts.

1999

- Proposed to allow corporations to offset interest on corporate tax overpayments and underpayments.
- Proposed to provide for civil penalties for misrepresentations of tax matters by third parties.
- Proposed to improve tax administration by sharing limited information with provinces.
- Proposed measures that will reduce tobacco contraband.

2000

- Proposing that the Minister of National Revenue be given authority to obtain judicial authorization, in certain circumstances, to take immediate action to protect GST revenues.
- Proposing to permit an official of the CCRA to provide relevant taxpayer information to the police for investigation purposes.
- Proposing to extend penalties under the Act to persons who hinder, molest or interfere with an official who is performing a collection duty.
- Proposing to allow Statistics Canada to provide taxpayer information to provincial statistical agencies solely for use in research and analysis.
- Proposing to allow individuals to offset interest on income tax overpayments and underpayments.

Notices of Ways and Means Motions

Notice of Ways and Means Motion to Amend the *Income Tax Act*

That it is expedient to amend the *Income Tax Act* to provide among other things:

Indexing

(1) That, for the 2000 and subsequent taxation years, the annual adjustment of dollar amounts which are subject to indexing under the Act by reference to the Consumer Price Index reflect the full increase of the Index for the 12-month period ending on September 30 of the preceding taxation year.

(2) That, for the purpose of indexing amounts for 2000,

(*a*) the basic personal amount for 1999 be considered to be $7,131 (indexed to $7,231 for 2000),

(*b*) the spouse and equivalent-to-spouse amounts for 1999 be considered to be $6,055 (indexed to $6,140 for 2000), and

(*c*) the income threshold for 1999 used in computing the spouse and equivalent-to-spouse tax credits be considered to be $606 (indexed to $614 for 2000).

Goods and Services Tax Credit

(3) That the amounts used in computing the goods and services tax credit be modified for payments in respect of specified months that are

(*a*) after June 2000 and before July 2001,

(i) to increase the income thresholds of $6,456 and $25,921 used for determining such payments to $6,546 and $26,284, respectively, and

(ii) to index, in accordance with paragraph (1), the amounts on which the amounts of $199 and $105 used in computing the credit are based, to $202 and $106 (as rounded), and to provide a one-time supplement to those rounded amounts, such that the amounts used in computing the credit for those months be $205 and $107, and

(*b*) after June 2001 and before July 2002, to provide, in addition to the indexing adjustment that would otherwise be made to the amounts on which the rounded amounts of $202 and $106 used in computing the credit for the previous twelve-month period are based, a one-time supplement equal to the amount, if any, by which $205 and $107, respectively, exceed the amounts obtained by indexing the amounts on which the rounded amounts of $202 and $106, respectively, are based.

Tax Payable by Individuals

(4) That the calculation of an individual's tax otherwise payable under Part I of the Act be modified to reduce the 26 per cent tax rate applicable to the portion of the individual's taxable income in excess of $29,590 and less than $59,180 (those two threshold amounts being indexed) to

(*a*) 25 per cent for the 2000 taxation year, and

(*b*) 24 per cent for the 2001 and subsequent taxation years,

such that the tax rate structure for the 2000 taxation year be

(*c*) 17 per cent of taxable income up to $30,004,

(*d*) 25 per cent of taxable income between $30,004 and $60,009, and

(*e*) 29 per cent of taxable income that exceeds $60,009.

Individual Surtax

(5) That the 5 per cent surtax required to be paid by an individual

(*a*) be based on the individual's tax otherwise payable under Part I of the Act in excess of $15,500, for the 2000 taxation year, and

(*b*) be reduced to 4 per cent of the individual's tax otherwise payable under Part I of the Act in excess of $18,500, for the 2001 and subsequent taxation years.

Canada Child Tax Benefit

(6) That the provisions of the Act relating to the base benefit and National Child Benefit supplement payable under the Canada Child Tax Benefit be modified in accordance with proposals described in the budget documents tabled by the Minister of Finance in the House of Commons on February 28, 2000.

Tax Reduction for Corporations

(7) That, for taxation years that end after December 31, 2000 (pro-rated for years that straddle that date),

(*a*) a deduction be provided from the tax otherwise payable under Part I of the Act for the year by a corporation (other than a corporation that is throughout the year a Canadian-controlled private corporation, an investment corporation, a mortgage investment corporation, a mutual fund corporation, or a non-resident-owned investment corporation), equal to 1 per cent of the amount by which the corporation's taxable income for the year exceeds the total of

(i) the total of the amounts in respect of which the corporation applied the deductions from tax provided by subsection 125.1(1) or (2) of the Act,

(ii) 3 times the resource allowance deducted under paragraph 20(1)(*v*.1) of the Act in computing the corporation's income for the year, and

(iii) if the corporation is a credit union, the amount in respect of which the corporation applied the deduction from tax provided by subsection 137(3) of the Act, and

(*b*) a deduction be provided from the tax otherwise payable under Part I of the Act for the year by a Canadian-controlled private corporation, equal to 1 per cent of the amount by which the corporation's taxable income for the year exceeds the total of

(i) the amounts that would, if subparagraph (*a*) applied to the corporation, be determined under clauses (*a*)(i) to (iii) in respect of the corporation for the year,

(ii) the least of the amounts determined under paragraphs 125(1)(*a*) to (*c*) of the Act in respect of the corporation's small business deduction for the year,

(iii) the corporation's aggregate investment income determined under subsection 129(4) of the Act for the year, and

(iv) 100/7 times the amount deducted from the corporation's tax for the year in accordance with the rules described in paragraph (8).

Accelerated Tax Reduction for Small Business Corporations

(8) That, for taxation years that end after December 31, 2000 (pro-rated for years that straddle that date), a deduction be provided from the tax otherwise payable under Part I of the Act for the year by a corporation that is throughout the year a Canadian-controlled private corporation, equal to 7 per cent of the amount by which

(*a*) the least of

(i) 150 per cent of the corporation's business limit for the year under paragraph 125(1)(*c*) of the Act,

(ii) the amount that would be the corporation's net active business income under paragraph 125(1)(*a*) of the Act for the year if the references in the definition "specified partnership income" in subsection 125(7) of the Act to $200,000 and $548 were read as references to $300,000 and $822, respectively, and

(iii) the taxable income amount determined under paragraph 125(1)(*b*) of the Act in respect of the corporation for the year, less the corporation's aggregate investment income determined under subsection 129(4) of the Act for the year,

exceeds

(*b*) the total of

(i) the least of the amounts determined under paragraphs 125(1)(*a*) to (*c*) of the Act in respect of the corporation's small business deduction for the year,

(ii) the total of the amounts in respect of which the corporation applied the deductions from tax provided by subsection 125.1(1) or (2) of the Act,

(iii) 3 times the resource allowance deducted under paragraph 20(1)(*v*.1) of the Act in computing the corporation's income for the year, and

(iv) if the corporation is a credit union, the amount in respect of which the corporation applied the deduction from tax provided by subsection 137(3) of the Act.

Capital Gains Inclusion Rate

(9) That for the 2000 and subsequent taxation years,

(*a*) subject to subparagraphs (*b*) and (*c*), a taxpayer's taxable capital gain, allowable capital loss and allowable business investment loss reflect a 3/4 inclusion rate in respect of gains and losses from dispositions of property before February 28, 2000 and a 2/3 inclusion rate in respect of other gains and losses for the year,

(*b*) a taxpayer's taxable capital gain in respect of dispositions to which paragraph 38(*a*.1) of the Act applies reflect a 3/8 inclusion rate for dispositions that occur before February 28, 2000 and a 1/3 inclusion rate for dispositions that occur after February 27, 2000 and before 2002,

(*c*) the amount included in a taxpayer's taxable capital gain, in a taxation year that begins after February 27, 2000, in respect of a capital gains reserve reflect a 2/3 inclusion rate,

(*d*) the deductions permitted in paragraphs 110(1)(*d*) to (*d*.3) of the Act in respect of amounts that are included in income for the year (other than amounts that would be included in income for the year if the year had ended on February 27, 2000) be determined as 1/3 of the amounts so included in income rather than as 1/4 of such amounts, and

(*e*) the rules for determining the capital gains deduction under section 110.6 of the Act and any other rules of determination under the Act take into account, where appropriate, the change in determination of a taxpayer's taxable capital gain and allowable capital loss from a disposition of a property.

Deferred Stock Option Benefits

(10) That the provisions of the Act which deem an individual who acquires a security under an option granted to the individual as an employee of a corporation (other than a Canadian-controlled private corporation), or as an employee of a mutual fund trust, to have received an employment benefit under subsection 7(1) of the Act that is required to be included in income be amended to provide

(*a*) that the income inclusion determined in connection with an individual's acquisition of a particular security after February 27, 2000 be deferred from the year in which the security is acquired to the earlier of the year in which the security is disposed of and the year in which the individual dies or becomes non-resident,

(*b*) that, in the case of an option granted to an employee to acquire a share of the capital stock of a corporation, the deferral not be available if, at the time the option was granted, the employee was a specified shareholder of the employer, of the corporation granting the option or of the corporation whose shares could be acquired under the option,

(*c*) that the deferral not be available in respect of a particular security acquired by an individual unless

(i) the individual would, if there were no deferral, be entitled in the year the security was acquired to deduct an amount under paragraph 110(1)(*d*) of the Act in respect of the employment benefit, and

(ii) where the security is a share of the capital stock of a corporation, it is of a class of shares that is listed on a stock exchange referred to in section 3200 or 3201 of the *Income Tax Regulations*,

(*d*) that the deferral of the income inclusion determined in connection with an individual's acquisition of a particular security under an option that had been granted to the individual by a particular entity, and that had vested in the individual in a particular year, be available only if the specified value of the particular security does not exceed $100,000 less the total of all amounts each of which is the specified value of a related security and, for this purpose,

(i) the specified value of a security acquired under an option is the fair market value of the security at the time the option was granted,

(ii) a security is a related security if

(A) it was acquired by the individual under an option that had been granted to the individual by the particular entity (or by an entity that was not dealing at arm's length with the particular entity) and that had vested in the individual in the particular year, and

(B) the income inclusion determined in connection with its acquisition is deferred because of this measure, and

(iii) the provisions of subsection 7(1.4) of the Act, dealing with exchanged options, apply, and

(*e*) that the deferral of the income inclusion be available only if arrangements have been established, in accordance with the budget documents tabled by the Minister of Finance in the House of Commons on February 28, 2000, to ensure accurate and timely reporting of the employment benefit.

Capital Gains Deferral

(11) That a mechanism be introduced to allow individuals (other than trusts) to defer the recognition of capital gains in respect of certain small business investments, in accordance with proposals described in the budget documents tabled by the Minister of Finance in the House of Commons on February 28, 2000.

Income Not Earned in a Province

(12) That, for the 2000 and subsequent taxation years, the surtax applicable to an individual's income not earned in a province be reduced to 48 per cent from 52 per cent.

Foreign Property

(13) That the current 20 per cent limit in respect of foreign property that may be held by pension and other deferred income plans be increased to 25 per cent for 2000 and to 30 per cent after 2000.

Disability Tax Credit

(14) That, for the 2000 and subsequent taxation years, the disability tax credit be extended to an individual

(*a*) who has, and has been certified to have, a severe and prolonged mental or physical impairment, and

(*b*) who has been certified by a medical doctor to be a person whose ability to perform a basic activity of daily living would all or substantially all of the time be markedly restricted but for

therapy (other than therapy that can reasonably be expected to be of benefit to persons who are not so impaired) that is

(i) essential to sustain a vital function of the individual, and

(ii) required to be administered at least three times each week for a total period averaging not less than 14 hours a week.

(15) That, for the 2000 and subsequent taxation years,

(*a*) a $2,941 supplement (indexed after 2000) be added in computing the disability amount that may be claimed in respect of a child who has not attained 18 years of age before the end of the year, and

(*b*) the amount of the supplement be reduced by the amount by which the total of child care and attendant care expenses claimed for the year in respect of the child exceeds $2,000 (indexed after 2000).

(16) That, for the 2000 and subsequent taxation years, the list of relatives to whom the unused portion of an individual's disability tax credit may be transferred in certain circumstances for use against Canadian tax payable be expanded to include a person who is a brother, sister, aunt, uncle, nephew or niece of the individual or of the individual's spouse.

Medical Expense Tax Credit

(17) That, for the 2000 and subsequent taxation years, there be added to the list of expenses eligible for the medical expense tax credit the portion of reasonable expenses, relating to the construction of the principal place of residence of an individual who lacks normal physical development or has a severe and prolonged mobility impairment, that can reasonably be considered to be incremental costs incurred to enable the individual to gain access to, or to be mobile or functional within, the individual's principal place of residence.

Attendant Care Expenses

(18) That, for the 2000 and subsequent taxation years,

(*a*) the attendant care expense deduction allowed in computing an individual's income be extended to an individual who incurs such expenses to attend a designated educational institution or

a secondary school at which the individual is enrolled in an educational program, and

(b) the maximum amount of the deduction allowed for the year to such an individual for all eligible attendant care expenses be 2/3 of the total of

(i) the individual's earned income for the year, and

(ii) the least of

(A) the amount by which the individual's income otherwise determined for the year exceeds the individual's earned income for the year,

(B) $15,000, and

(C) $375 multiplied by the number of weeks in the year during which the individual attends the institution or school.

Child Care Expense Deduction

(19) That, for the 2000 and subsequent taxation years, the maximum annual amount deductible for child care expenses be increased from $7,000 to $10,000 for each eligible child in respect of whom a disability tax credit may be claimed.

Personal-Use Property

(20) That the provisions of the Act relating to the deemed proceeds of disposition and adjusted cost base applicable to personal-use property not apply to property of a taxpayer that is acquired by the taxpayer after February 27, 2000 as part of an arrangement under which the property is gifted to a qualified donee.

Charitable Donations Tax Credit

(21) That the charitable donations tax credit be extended to apply in respect of amounts that are paid directly to a qualified donee as a beneficiary, as a consequence of an individual's death that occurs after 1998, under

(*a*) a life insurance policy under which the individual was the policyholder and the individual's life was insured,

(*b*) the individual's coverage under a group life insurance policy under which the individual's life was insured, or

(*c*) a registered retirement savings plan or registered retirement income fund under which the individual was the annuitant.

Donations of Ecological Gifts

(22) That the provisions of the Act relating to ecological gifts be modified to

(*a*) halve the income inclusion rate for capital gains from such gifts (other than gifts made to a private foundation) made after February 27, 2000,

(*b*) require the donor to file with the return of income for the taxation year in which the gift was made a document obtained from the Minister of the Environment certifying, for the purposes of the Act relating to charitable gifts, the fair market value of the gift as determined by that Minister,

(*c*) provide a donor with a right to appeal to the Tax Court of Canada a redetermination by that Minister of the fair market value of a gift that has been made, and

(*d*) provide that such a valuation apply for all purposes of the Act relating to charitable gifts for the two-year period following the time of the last determination or redetermination of the value.

Offsetting of Interest on Personal Tax Overpayments and Underpayments

(23) That, for individuals other than trusts, the taxable amount of refund interest accruing over any period after 1999 on overpayments of income tax be reduced by the amount of any arrears interest accruing over the same period on unpaid income tax.

Donation of Stock Option Shares

(24) That where

(*a*) an individual acquires, after February 27, 2000 and before 2002, a security under an option that was granted to the individual as an employee of a corporation or mutual fund trust,

(*b*) the individual disposes of the security, in the year it is acquired and not more than 30 days after its acquisition, by donating it to a qualified donee that is not a private foundation,

(*c*) the individual is entitled to deduct an amount under paragraph 110(1)(*d*) of the Act in respect of the employment benefit determined under subsection 7(1) of the Act in connection with the acquisition of the security, and

(*d*) if there were a capital gain determined in connection with the individual's disposition of the security, the gain would qualify for the reduced inclusion rate under paragraph 38(*a*.1) of the Act,

the individual be entitled to deduct, in computing taxable income for the year in which the security is acquired, an additional amount equal to 1/3 of the amount that would be the employment benefit if the fair market value of the security at the time of acquisition were the lesser of that value and the security's fair market value at the time of donation.

Scholarships, Fellowships and Bursaries

(25) That, for the 2000 and subsequent taxation years, the $500 exemption in respect of the total of all amounts received in the year by an individual on account of scholarships, fellowships, bursaries and certain prizes be increased by $2,500 for scholarships, fellowships and bursaries received by the individual in connection with the individual's enrolment at a designated educational institution in a program in respect of which the individual may claim the education tax credit.

Thin Capitalization

(26) That, for taxation years that begin after 2000, the provisions of the Act relating to thinly capitalized corporations be modified

(*a*) to reduce, from 3:1 to 2:1, the ratio of debt to equity for the purposes of the limit on interest deductibility in subsection 18(4) of the Act,

(*b*) to apply an average ratio of debt to equity for the taxation year in determining the limit on interest deductibility applicable to a corporation under subsection 18(4) of the Act, based on calculations of

(i) the corporation's retained earnings at the beginning of the year,

(ii) the corporation's contributed surplus and paid-up capital at the beginning of each month of the year to the extent they are attributable to specified non-residents, and

(iii) the greatest total amount of debt owing by the corporation to specified non-residents at any time in each month of the year,

(*c*) to expand the anti-avoidance rule in subsection 18(6) of the Act to deem indebtedness of a corporation to a third party that is guaranteed or secured by a specified non-resident to be debt owing by the corporation to the specified non-resident, and

(*d*) to repeal subsection 18(8) of the Act, which provides an exemption for developers and manufacturers of aircraft and aircraft components.

Non-Resident-Owned Investment Corporations

(27) That,

(*a*) a corporation that elected before February 28, 2000 to be taxed as a non-resident-owned investment corporation cease to be such a corporation no later than the end of its last taxation year that begins before 2003, and

(*b*) no election to be taxed as a non-resident-owned investment corporation be permitted after February 27, 2000.

Weak Currency Debt

(28) That a "weak currency debt" be defined as indebtedness incurred by a taxpayer at a particular time after February 27, 2000, in respect of a borrowing of money or an acquisition of property, in a currency (the "weak currency") other than Canadian currency, where

(*a*) at any time (the "exchange date") the taxpayer uses the borrowed money or the acquired property, directly or indirectly, to acquire funds, or settle an obligation, in another currency (the "final currency")

(i) which funds are used for the purpose of earning income from a business or property and are not used to acquire funds in a different currency, or

(ii) which obligation was incurred for the purpose of earning income from a business or property and was not incurred to acquire funds in a different currency,

(*b*) the amount of the indebtedness (together with any other indebtedness that can reasonably be regarded as having been incurred as part of a series of weak currency debt transactions that includes the incurring of the indebtedness) exceeds $500,000, and

(*c*) the rate at which interest is payable in the weak currency in respect of the indebtedness exceeds by more than 2 percentage points (200 basis points) the rate at which interest would have been payable in the final currency if at the particular time the taxpayer had incurred an equivalent amount of indebtedness in the final currency on the same terms, with such modifications as the difference in currency requires.

(29) That the following rules apply in respect of a weak currency debt of a taxpayer (other than a corporation described in one or more of paragraphs (*a*), (*b*), (*c*) and (*e*) of the definition “specified financial institution” in subsection 248(1) of the Act):

(*a*) no deduction on account of interest that accrues on the indebtedness after the later of June 30, 2000 and the exchange date shall exceed the amount (expressed in Canadian currency) of interest in the final currency that would have accrued after that day if, at the time of incurring the indebtedness, the taxpayer had instead incurred an equivalent amount of indebtedness in the final currency on the same terms, with such modifications as the difference in currency requires;

(*b*) the taxpayer’s foreign exchange gain or loss

(i) on the settlement or extinguishment of the indebtedness, and

(ii) on the settlement of any hedge in respect of the indebtedness

shall be on income account; and

(*c*) in computing the taxpayer's foreign exchange gain or loss on the settlement or extinguishment of the indebtedness, the amount of any interest on the indebtedness that was not deductible because of this paragraph shall be treated as an additional amount paid by the taxpayer to settle or extinguish the indebtedness.

(30) That in applying the rules described in paragraph (29),

(*a*) a hedge in respect of the indebtedness be defined as any agreement entered into by the taxpayer

(i) that can reasonably be regarded as having been entered into by the taxpayer primarily to reduce the risk to the taxpayer, with respect to payments of principal or interest on the indebtedness, of currency fluctuations, and

(ii) that is identified by the taxpayer as a hedge in respect of the indebtedness in a written notice filed with the Minister on or before the later of July 31, 2000 and the 30th day after the taxpayer agrees to the hedge;

(*b*) where there is a hedge in respect of any portion of interest in the weak currency paid or payable on the indebtedness, the amount (expressed in Canadian currency) paid or payable in the weak currency for a period on account of interest be deemed to be that amount minus the amount of any foreign exchange gain, or plus the amount of any foreign exchange loss, on the hedge in respect of the interest paid or payable for the period; and

(*c*) if the amount (expressed in the weak currency) of the indebtedness is decreased before maturity by a repayment of principal, the amount (expressed in the weak currency) repaid be deemed *ab initio* to have been a separate indebtedness and the amount (expressed in the weak currency) of the original indebtedness be reduced accordingly.

Government Assistance – SR & ED

(31) That for taxation years that end after February 2000, where, for the purpose of computing income or taxable income relevant in calculating an income tax payable to a province for a taxation year, a corporation becomes entitled to deduct an amount

in computing income or taxable income in respect of an expenditure on scientific research and experimental development and that amount exceeds the amount of the expenditure, the specified percentage of the excess be considered for the purposes of the Act to be government assistance received in the year in respect of scientific research and experimental development, and, for this purpose, the specified percentage is

(*a*) where the corporation's expenditure limit for the year, as determined by subsection 127(10.2) of the Act, is nil, the maximum provincial tax rate applicable to active business income earned in the province by a corporation for the year, and

(*b*) in any other case, the provincial tax rate applicable to small business income earned in the province by a corporation for the year.

Foreign Tax Credits – Oil and Gas Production Sharing

(32) That, in applying the foreign tax credit rules in section 126 of the Act in respect of an oil or gas business carried on in a taxation year by a resident of Canada in a country, other than Canada, that imposes an income or profits tax on other business income, there be treated as foreign taxes paid by the taxpayer for the year amounts that

(*a*) become receivable in the year by a government of that country (or its agent) because of an obligation of the taxpayer in respect of the business,

(*b*) are computed by reference to the amount or value of oil or gas produced or extracted, net of operating and capital costs,

(c) are not royalties under the foreign country's law, payments made in a purely commercial capacity or otherwise creditable foreign taxes, and

(*d*) do not exceed, in total, 40 per cent of the taxpayer's income from the business for the year, less amounts otherwise creditable as foreign taxes,

and that this provision apply to those taxation years of a taxpayer that begin after the earlier of December 31, 1999 and a date selected by the taxpayer (which date may in no case be earlier than December 31, 1994).

Foreign Tax Credit

(33) That, in computing a taxpayer's income for a year from sources in a foreign country for the purposes of the foreign tax credit rules in section 126 of the Act, there be deducted an amount equal to the total of

(*a*) the greater of

(i) the maximum amount that

(A) would, if the taxpayer's only foreign resource income for the year (determined under subparagraph 66(4)(*b*)(ii) of the Act) were from those sources, be deductible under subsection 66(4) of the Act in computing the taxpayer's income for the year, and

(B) can reasonably be considered to relate to those sources, and to be in respect of foreign exploration and development expenses incurred in a taxation year that begins before 2001, and

(ii) the amount deducted under subsection 66(4) of the Act in computing the taxpayer's income for the year that can reasonably be considered to relate to those sources and to be in respect of foreign exploration and development expenses incurred in a taxation year that begins before 2001, and

(*b*) the greater of

(i) the maximum amount that would be deductible in computing the taxpayer's income for the year in respect of those sources in connection with a balance described in paragraph (35) if the amount determined under paragraph (37) were nil, and

(ii) the amount deducted in computing the taxpayer's income for the year in respect of those sources in connection with a balance described in paragraph (35),

and that this paragraph apply to taxation years of a taxpayer that begin after the earlier of December 31, 1999 and the date selected by the taxpayer for the application of the rule described in paragraph (32).

Foreign Exploration and Development Expenses

(34) That an outlay made after February 27, 2000 by a person or partnership not be treated as a foreign exploration and development expense (FEDE) unless

(*a*) the outlay was made pursuant to an agreement in writing made by the person or partnership before February 28, 2000,

(*b*) the outlay was for the acquisition of foreign resource property by the person or partnership, or

(*c*) the outlay can reasonably be considered to have been incurred for the purpose of enhancing the value of foreign resource property owned or to be owned by the person or partnership.

(35) That, for outlays made in taxation years that begin after 2000, separate FEDE balances for a taxpayer be determined in respect of each country to which the taxpayer's FEDE relates.

(36) That, for FEDE incurred in a taxation year that begins after 2000, a taxpayer's FEDE deduction in respect of a country for the year be limited to the total of

(*a*) the greater of 10 per cent of the taxpayer's FEDE balance in respect of the country at the end of the year and the lesser of

(i) where the year is the taxpayer's last taxation year of residence in Canada, that FEDE balance and, in any other case, 30 per cent of that FEDE balance, and

(ii) the lesser of

(A) the amount, if any, by which the taxpayer's foreign resource income in respect of the country for the year (determined in accordance with subparagraph 66(4)(*b*)(ii) of the Act) exceeds the taxpayer's FEDE deduction for the year in respect of the country that relates to FEDE incurred in taxation years that begin before 2001, and

(B) the amount, if any, by which the taxpayer's total foreign resource income in respect of all countries for the year (determined in accordance with subparagraph 66(4)(*b*)(ii) of the Act) exceeds the taxpayer's total FEDE deduction for the year that relates to FEDE incurred in taxation years that begin before 2001, and

(*b*) the lesser of

(i) the amount, if any, by which that FEDE balance exceeds the amount determined under subparagraph (*a*), and

(ii) such portion of the taxpayer's specified foreign resource income as is designated by the taxpayer in respect of the country and no other country.

(37) That a taxpayer's specified foreign resource income for a taxation year be equal to the lesser of

(*a*) the amount, if any, by which the taxpayer's total foreign resource income for the year in respect of all countries (determined in accordance with subparagraph 66(4)(*b*)(ii) of the Act) exceeds the total of

(i) the maximum total FEDE deductions, in respect of all countries, that would be permitted in computing the taxpayer's income for the year in respect of FEDE incurred in taxation years that begin after 2000 if the taxpayer's specified foreign resource income for the year were nil, and

(ii) the amount deducted by the taxpayer for the year under subsection 66(4) of the Act in computing the taxpayer's income for the year in respect of FEDE incurred in taxation years that begin before 2001, and

(*b*) the amount, if any, by which

(i) 30 per cent of the taxpayer's total FEDE balances at the end of the year in respect of all countries in respect of expenses incurred in taxation years that begin after 2000,

exceeds

(ii) the maximum total FEDE deductions, in respect of all countries, that would be permitted in computing the taxpayer's income for the year in respect of FEDE incurred in taxation years that begin after 2000 if the taxpayer's specified foreign resource income for the year were nil.

(38) That, where a taxpayer ceases after February 27, 2000 to reside in Canada,

(*a*) the taxpayer's FEDE deduction for the taxpayer's last year of residence in Canada in respect of expenses incurred in taxation years that began before 2001 be limited to the greater of the taxpayer's foreign resource income for that year and 10 per cent of the taxpayer's FEDE balance at the end of that year, and

(*b*) the taxpayer be permitted for each subsequent taxation year of residence outside Canada to deduct up to 10 per cent of the taxpayer's FEDE balance at the end of that subsequent year in computing the taxpayer's taxable income earned in Canada.

(39) That, for taxation years that begin after the earlier of December 31, 1999 and the date selected by the taxpayer for the application of the rule described in paragraph (32), all FEDE deductions claimed by a taxpayer be allocated, wherever relevant for the purposes of the Act, on a country-by-country basis.

(40) That, for taxation years that begin after 2000, the successor rules in section 66.7 of the Act reflect the 30 per cent FEDE balance deduction limit.

(41) That section 79.1 of the Act not apply in respect of acquisitions after February 27, 2000 of foreign resource property from a person (other than a person resident in Canada) or a partnership (other than a partnership each member of which is resident in Canada).

M&P Rate for Producing Steam for Sale

(42) That, for the purpose only of applying the manufacturing and processing profits tax rate reduction in subsection 125.1(2) of the Act for the 2000 and subsequent taxation years, the production of steam for sale be considered manufacturing or processing.

Hindering a Federal Tax Official

(43) That the penalty applying under section 238 of the Act to a person who fails to comply with subsection 231.5(2) of the Act be extended to persons who hinder, molest, interfere with or prevent an official in the performance of a collection function, and to persons who attempt to hinder, molest, interfere with or prevent an official in the performance of a collection function or any other duty to which that subsection currently applies.

Communication of Taxpayer Information

(44) That the provisions of the Act relating to the communication of taxpayer information be amended to permit an official to provide

(*a*) taxpayer information, relating to the 1997 and subsequent taxation years, to any person solely for the purpose of enabling the Chief Statistician, as defined by section 2 of the *Statistics Act*, to provide to a statistical agency of a province statistical data that is pertinent to activities carried on in the province and that is to be used by the agency solely for research and analysis, if the information relates to

(i) a corporation, or

(ii) an individual, where the information is solely in respect of the computation of income from the individual's business,

and for the purpose of subsection 17(2) of the *Statistics Act*, where such information was collected before any measure giving effect to this paragraph is assented to, the information shall be deemed to have been collected at the time at which it is so provided to the provincial statistical agency, and

(*b*) taxpayer information to a police officer, within the meaning assigned by subsection 462.48(17) of the *Criminal Code*, where

(i) an official has performed or is performing an act which the *Income Tax Act* obliges or authorizes the official to perform,

(ii) such information can reasonably be regarded as necessary to ascertain the identity of a person and the circumstances in which an offence under the *Criminal Code* may have been committed by the person in respect of an official of the Canada Customs and Revenue Agency, or in respect of any person related to that official,

(iii) the offence can reasonably be considered to be related to the official's act, referred to in clause (i), and

(iv) the information is provided solely for the purpose of the investigation or prosecution of the offence.

Notice of Ways and Means Motion to Amend the *Excise Tax Act*

That it is expedient to amend the *Excise Tax Act* to provide among other things:

Export Distribution Centres

(1) That the following definitions be added to Part IX of the Act for the purposes of any enactment founded on this paragraph or any of paragraphs (2) to (17):

"added property" of a person means tangible personal property (other than property that serves as evidence of the payment of postage) or software that the person incorporates into, attaches to, combines or assembles with, or uses to pack, other property that is not property of the person held otherwise than for sale by the person.

"base value" of property that a particular person imports or obtains physical possession of in Canada from another person means

(*a*) if the particular person imports the property, the value that is or would be, but for subsection 215(2) of the Act, deemed under subsection 215(1) of the Act to be the value of the property for the purposes of Division III of Part IX of the Act; and

(*b*) in any other case, the fair market value of the property at the time the particular person obtains physical possession of it in Canada.

"basic service" means any of the following services performed in respect of goods, to the extent that, if the goods were held in a bonded warehouse at the time the service is performed, it would be feasible, given the stage of processing of the goods at that time, to perform that service in the warehouse and it would be permissible to do so according to the *Customs Bonded Warehouses Regulations*:

(*a*) disassembling or reassembling, if the goods have been assembled or disassembled for packing, handling or transportation purposes;

(*b*) displaying;

(*c*) inspecting;

(*d*) labelling;

(*e*) packing;

(*f*) removing, for the sole purpose of soliciting orders for goods or services, a small quantity of material, or a portion, a piece or an individual object, that represents the goods;

(*g*) storing;

(*h*) testing; or

(*i*) any of the following that do not materially alter the characteristics of the goods:

(i) cleaning,

(ii) complying with any applicable law of Canada or of a province,

(iii) diluting,

(iv) normal maintenance and servicing,

(v) preserving,

(vi) separating defective goods from prime quality goods,

(vii) sorting or grading, and

(viii) trimming, filing, slitting or cutting.

"bonded warehouse" has the meaning assigned by subsection 2(1) of the *Customs Act*.

"customer's good", in respect of a particular person, means tangible personal property of another person that the particular person imports or obtains physical possession of in Canada for the purpose of supplying a service, or supplying added property, in respect of the tangible personal property.

"domestic inventory" of a person means tangible personal property that the person acquires in Canada, or acquires outside Canada and imports, for the purpose of selling the property separately for consideration in the ordinary course of a business carried on by the person.

"export revenue" of a particular person for a fiscal year means the total of all amounts each of which is consideration, included in determining the income from a business of the person for the year, for

(*a*) a supply by way of sale of an item of domestic inventory of the person that is made outside Canada or is included in Part V of Schedule VI to the Act (other than sections 2.1, 3, 11, 14 and 15.1 of that Part);

(*b*) a supply by way of sale of added property acquired by the person for the purpose of processing in Canada particular property where the particular property, or all the products resulting from that processing, as the case may be, are exported after that processing is complete without being consumed, used, transformed or further processed, manufactured or produced in Canada by another person, except to the extent reasonably necessary or incidental to the transportation of the particular property or those products; or

(*c*) a supply of a service of processing, storing or distributing tangible personal property of another person if the property, or all the products resulting from that processing, as the case may be, are exported, after the processing in Canada, if any, by the particular person is complete, without being consumed, used, transformed or further processed, manufactured or produced in Canada by any person other than the particular person, except to the extent reasonably necessary or incidental to the transportation of that other property or those products.

"export revenue percentage" of a person for a fiscal year means the percentage that the person's export revenue for the year is of the person's specified total revenue for the year.

"labelling" includes marking, tagging and ticketing.

"packing" includes unpacking, repacking, packaging and repackaging.

"processing" includes adjusting, altering, assembling, labelling, modifying, packing and any basic service.

"specified total revenue" of a person for a fiscal year of the person means the total of all amounts each of which is consideration, included in determining the income from a business of the person for the year, for a supply that is made by the person (or that would be made by the person but for any provision of Part IX of the Act that deems the supply to be made by another person) other than

(*a*) a supply of a service in respect of property that the person neither imports, nor obtains physical possession of in Canada, for the purpose of providing the service;

(*b*) a supply by way of sale of property that the person acquires for the purpose of selling the property for consideration but that is neither acquired in Canada nor imported by the person;

(*c*) a supply by way of sale of an added property that the person acquires for the purpose of processing other tangible personal property that the person neither imports nor obtains physical possession of in Canada; and

(*d*) a supply by way of sale of capital property of the person.

"substantial alteration of property" by a person means

(*a*) manufacturing or producing, or engaging another person to manufacture or produce, property (other than capital property of the person) in the course of a business carried on by the person; or

(*b*) any processing of property of the person (other than capital property) that is intended for sale by the person, or for use as added property, in the course of a business carried on by the person, if the prescribed percentage is less than the amount (expressed as a percentage) determined by the formula

$$A/B$$

where

A is the portion of the total cost to the person of the property, or of the products resulting from the processing of the property, as the case may be, after all processing of the property by or for the person is complete, that is reasonably attributable to

(i) salary, wages or other remuneration paid or payable to employees of the person, excluding any amounts that are reasonably attributable to the performance of basic services, or

(ii) consideration paid or payable by the person to engage other persons to process the property for the person, excluding any portion of such consideration that is reasonably attributable to the performance of basic services or that is reasonably attributed by the other persons to other tangible personal property supplied in connection with the processing of the property, and

B is the total cost to the person of the property, or of the products resulting from the processing of the property, as the case may be, after all processing of the property by or for the person is complete.

(2) That a person's percentage value added in respect of customers' goods for a fiscal year of the person be defined as the amount (expressed as a percentage) determined by the formula

$$A / (A + B)$$

where

A is the total of all consideration, included in determining the income from a business of the person for the year, for supplies of services, or of added property, in respect of customers' goods, other than the portion of such consideration that is reasonably attributable to the performance of basic services or to the provision of added property used in the performance of basic services, and

B is the total of the base values of the customers' goods.

(3) That the Minister of National Revenue may, on the application of a person who is registered under Subdivision d of Division V of Part IX of the Act and who is engaged exclusively in commercial activities, authorize the person to use, beginning on a particular day in a fiscal year of the person, an export distribution centre certificate for the purposes of any enactments founded on paragraphs (15) and (17), if it can reasonably be expected that

(*a*) none of the activities engaged in by the person during the year will constitute the substantial alteration of property;

(*b*) the person's percentage value added in respect of customers' goods for the year will not exceed the prescribed percentage; and

(*c*) the person's export revenue percentage for the year will equal or exceed 90 per cent.

(4) That an authorization to use an export distribution centre certificate be subject to such terms and conditions as the Minister of National Revenue may from time to time specify.

(5) That, for the purpose of determining the export revenue of a person or a person's percentage value added in respect of customers' goods, any supply between the person and another person with

whom the person is not dealing at arm's length that is made for no consideration or for less than fair market value be deemed to be made for consideration equal to fair market value.

(6) That an application for authority to use an export distribution centre certificate be required to be made in prescribed form containing prescribed information and be filed with the Minister of National Revenue in prescribed manner.

(7) That, where the Minister of National Revenue authorizes a person to use an export distribution centre certificate, the Minister be required to notify the person in writing of the authorization, its effective date and its expiry date, and the number assigned by the Minister that identifies the person or the authorization and that must be disclosed by the person when providing the certificate.

(8) That the Minister of National Revenue may, subject to giving reasonable written notice, revoke the authorization of a person to use an export distribution centre certificate, effective on a day in a particular fiscal year of the person, where

(*a*) the person fails to comply with any condition attached to the authorization or with any provision of Part IX of the Act;

(*b*) it can reasonably be expected that the conditions described in paragraph (3) would not be met if the fiscal year referred to therein were the particular fiscal year; or

(*c*) the person has requested in writing that the authorization be revoked as of that day.

(9) That, subject to any enactment founded on paragraph (8), an authorization of a person to use an export distribution centre certificate be deemed to have been revoked, effective immediately after a fiscal year of the person, where

(*a*) the person had engaged in the substantial alteration of property during that year;

(*b*) the person's percentage value added in respect of customers' goods for that year exceeds the percentage prescribed for the purpose of an enactment founded on paragraph (3); or

(*c*) the person's export revenue percentage for that year is less than 80 per cent.

(10) That an authorization referred to in paragraph (3) cease to have effect immediately before the earlier of

(*a*) the day on which a revocation of the authorization becomes effective; and

(*b*) the day that is three years after the day on which the authorization became effective.

(11) That, where an authorization of a person to use an export distribution centre certificate is revoked, effective on a particular day, the person not be entitled to obtain another such authorization before

(*a*) the day that is two years after the particular day, if the authorization was revoked because the person failed to comply with a condition of the authorization or any provision of Part IX of the Act; and

(*b*) the first day of the second fiscal year of the person beginning after the particular day, in any other case.

(12) That, where a supply of property that is a zero-rated supply under an enactment founded on paragraph (15) is made to a person who had been granted an authorization to use an export distribution centre certificate and, at the time the supply is made, the authorization is no longer in effect or the property is not being acquired by the person for use or supply in the course of commercial activities of the person as domestic inventory or added property, the person be required, in determining the net tax of the person for the reporting period that includes the earliest day on which tax would, but for that enactment, have become payable in respect of the supply, to add an amount equal to interest, at the rate prescribed for the purposes of paragraph 280(1)(*b*) of the Act plus 4 per cent per year compounded daily, on the total amount of tax that would have been payable in respect of the supply if it had not been a zero-rated supply, computed for the period beginning on that earliest day and ending on the day on or before which the return under section 238 of the Act for that reporting period is required to be filed.

(13) That, where an authorization of a person to use an export distribution centre certificate is in effect at any time in a fiscal year of the person and the export revenue percentage of the person for the year is less than 90 per cent or the authorization ceases in the year to apply because of a revocation in the circumstances described

in paragraph (9), the person be required to add an amount, in determining the person's net tax for the first reporting period of the person following that fiscal year, equal to the amount determined by the formula

$$A \times B/12$$

where

A is the total of

(*a*) the product obtained when the rate set out in subsection 165(1) of the Act is multiplied by the total of all amounts each of which is consideration paid or payable by the person for a supply of property acquired by the person in the year in a non-participating province that was a zero-rated supply only because of an enactment founded on paragraph (15), other than a supply in respect of which the person is required to add an amount in determining net tax pursuant to an enactment founded on paragraph (12),

(*b*) the product obtained when the total of the rates set out in subsections 165(1) and (2) of the Act is multiplied by the total of all amounts each of which is consideration paid or payable by the person for a supply of property acquired by the person in the year in a participating province that was a zero-rated supply only because of an enactment founded on paragraph (15), other than a supply in respect of which the person is required to add an amount in determining net tax pursuant to an enactment founded on paragraph (12), and

(*c*) the product obtained when the rate set out in subsection 165(1) of the Act is multiplied by the total of all amounts each of which is the value that is or would be, but for subsection 215(2) of the Act, deemed under subsection 215(1) of the Act to be the value, for the purposes of Division III of Part IX of the Act, of a good that was imported by the person in the year and in respect of which, by reason only of an enactment founded on paragraph (17), tax under that Division did not apply, and

B is the total of the rate of interest prescribed for the purpose of paragraph 280(1)(*b*) of the Act and 4 per cent.

(14) That a person who receives a zero-rated supply of property, under an enactment founded on paragraph (15), at a time at which the person's authorization to use an export distribution centre certificate is no longer in effect, or who is not acquiring the property for use or supply as domestic inventory or as added property, be liable for tax, under section 218 and, where applicable, section 218.1, of the Act, calculated on the value of the consideration for that supply, unless the property is acquired by the person for consumption, use or supply exclusively in the course of commercial activities of the person.

(15) That Part V of Schedule VI to the Act be amended to include, as a zero-rated supply, a sale of property (other than an excisable good and property that is a continuous transmission commodity that the recipient intends to export by means of a wire, pipeline or other conduit) made to a recipient who is registered under Subdivision d of Division V of Part IX of the Act, where

(*a*) the recipient provides the supplier with an export distribution centre certificate certifying that an authorization to use the certificate is in effect at the time the supply is made and that the property is being acquired for use or supply as domestic inventory or added property of the person and disclosing the number referred to in paragraph (7) as well as the expiry date of the authorization;

(*b*) the total amount, included in a single invoice or agreement, of the consideration for that supply and for all other supplies, if any, that are made to the recipient and are otherwise included in this paragraph, is at least $1,000; and

(*c*) if an authorization to use the certificate is not in effect at the time the supply is made or the recipient is not acquiring the property for use or supply as domestic inventory or as added property in the course of commercial activities of the recipient, it is the case that, at the latest time at which tax in respect of the supply would have become payable if the supply were not a zero-rated supply, the supplier did not know, and could not reasonably be expected to have known, that the authorization was not in effect at the time the supply was made or that the recipient was not acquiring the property for that purpose.

(16) That an enactment founded on any of paragraphs (1) to (15) be deemed to come into force on January 1, 2001 and apply in respect of supplies made after December 31, 2000.

(17) That Schedule VII to the Act be amended to exempt from tax under Division III of Part IX of the Act a good imported after December 31, 2000 that is an item of domestic inventory or added property of the importer or a customer's good, where the importer is registered under Subdivision d of Division V of that Part and has been granted an authorization that is in effect at that time to use an export distribution centre certificate, provided that,

(*a*) when the good is accounted for under section 32 of the *Customs Act*, the importer certifies that the authorization is in effect at that time and that the good is an item of domestic inventory or added property of the importer or a customer's good and the importer discloses the number referred to in paragraph (7) and the expiry date of the authorization; and

(*b*) the importer has posted any security required under section 213.1 of the Act in respect of the importation of the good.

Drop Shipments

(18) That the drop-shipment rules under section 179 of the Act be amended to provide that

(*a*) the specific exclusion from tax-free treatment for certain services be removed in the case of supplies of storage services in respect of which tax would, but for an enactment founded on this paragraph, become payable after February 28, 2000; and

(*b*) with respect to any supply by way of sale in Canada of railway rolling stock that is made to a non-resident person who is not registered under Subdivision d of Division V of Part IX of the Act and in respect of which tax would, but for an enactment founded on this paragraph, become payable after February 28, 2000, where the first use of the rolling stock after the supplier transfers possession of it is to transport goods in the course of exporting the rolling stock, that use be deemed to be entirely outside Canada for the purpose of treating the sale as having been made outside Canada, provided that the rolling

stock is exported within 60 days after its delivery to the non-resident person.

Export Trading Houses

(19) That the export certificate rules under subsection 221(3.1), section 221.1 and Schedule VI, of the Act be amended to provide that:

(*a*) a registrant who has been authorized to use an export certificate be entitled to request in writing that the Minister of National Revenue revoke the authorization;

(*b*) if the Minister of National Revenue authorizes a registrant to use an export certificate, the Minister be required to notify the registrant in writing of the authorization, its effective date and expiry date and the number assigned by the Minister that identifies the registrant or the authorization and that must be disclosed by the registrant when providing the certificate to a supplier;

(*c*) when providing an export certificate to a supplier, a registrant be required to disclose the number assigned by the Minister of National Revenue that identifies the registrant or the authorization and to certify that an authorization to use the certificate is in effect at that time;

(*d*) the mechanism for relieving a supplier of the obligation to collect tax on a supply for which the recipient provides an export certificate be the inclusion of the supply in Part V of Schedule VI to the Act as a zero-rated supply;

(*e*) in order for a supply to be a zero-rated supply under an enactment founded on this paragraph, it must be the case that the supplier did not know, and could not reasonably be expected to have known, at the latest time at which tax in respect of the supply would have become payable if the supply were not a zero-rated supply, that the authorization of the recipient to use the certificate was not in effect at the time the supply was made or that the recipient would not export the property in the circumstances set out in section 1 of Part V of Schedule VI to the Act;

(*f*) the mechanism for requiring the payment of tax by a registrant who has used an export certificate to acquire property but who

was not authorized to do so at the time the supply was made, or who failed to subsequently export the property in the circumstances set out in section 1 of Part V of Schedule VI to the Act, be the inclusion of the supply in Division IV of Part IX of the Act, but no such inclusion be required if the registrant acquired the property for consumption, use or supply exclusively in the course of commercial activities of the registrant;

(*g*) if a registrant has used an export certificate to acquire property but was not authorized to do so at the time the supply was made, or the registrant failed to subsequently export the property in the circumstances set out in section 1 of Part V of Schedule VI to the Act, the registrant be required, in determining the net tax of the registrant for the reporting period that includes the earliest day on which tax would have become payable in respect of the supply if it had not been a zero-rated supply, to add an amount equal to interest, at the rate prescribed for the purpose of paragraph 280(1)(*b*) of the Act plus 4 per cent per year compounded daily, on the total amount of tax that would have been payable in respect of the supply, computed for the period beginning on that earliest day and ending on the day on or before which the registrant's return under section 238 of the Act for that reporting period is required to be filed; and

(*h*) if a registrant's authorization to use an export certificate is revoked after the last day of a fiscal year of the registrant because the registrant failed to meet the test set out in subsection 221.1(6) of the Act in respect of that year, the registrant be required to add an amount in determining the registrant's net tax for the first reporting period of the registrant following that year equal to the amount determined by the formula

$$A \times B/12$$

where

A is the total of

(i) the product obtained when the rate set out in subsection 165(1) of the Act is multiplied by the total of all amounts each of which is consideration paid or payable by the registrant for a supply in a non-participating province of an item of inventory acquired by the registrant in the year that is a zero-rated supply as a result of the registrant having provided an export certificate to the supplier, other than a

supply in respect of which the registrant is otherwise required, under an enactment founded on this paragraph, to add an amount in determining net tax, and

(ii) the product obtained when the total of the rates set out in subsections 165(1) and (2) of the Act is multiplied by the total of all amounts each of which is consideration paid or payable by the registrant for a supply in a participating province of an item of inventory acquired by the registrant in the year that is a zero-rated supply as a result of the registrant having provided an export certificate to the supplier, other than a supply in respect of which the registrant is otherwise required, under an enactment founded on this paragraph, to add an amount in determining net tax, and

B is the total of the rate of interest prescribed for the purpose of paragraph 280(1)(*b*) of the Act and 4 per cent.

(20) That any enactment founded on paragraph (19) be deemed to come into force on January 1, 2001 and apply in respect of supplies made after December 31, 2000.

New Rental Property Rebate

(21) That the following definitions be added to Part IX of the Act for the purposes of any enactment founded on this paragraph or any of paragraphs (22) to (32):

"first use", in respect of a residential unit, means the first use of the unit after the construction or last substantial renovation of the unit.

"percentage of total floor space", in respect of a residential unit forming part of a residential complex or part of an addition to a multiple unit residential complex, means the percentage that the total square metres of floor space occupied by the unit is of the total square metres of floor space occupied by all of the residential units in the residential complex or addition, as the case may be.

"qualifying residential unit" of a person, at a particular time, means

(*a*) a residential unit in which the person has, at or immediately

before the particular time, an ownership interest or an interest that arises as a result of being a lessee or sublessee of the unit or of the complex in which the unit is situated, where

(i) at the particular time, the unit is a self-contained residence,

(ii) that interest is held by the person for the purpose of making exempt supplies included in section 5.1, 6, 6.1 or 7 of Part I of Schedule V to the Act,

(iii) it is the case, or can reasonably be expected by the person at the particular time to be the case, that the first use of the unit is or will be

(A) as the primary place of residence of the person or a relation of the person, or of another lessor of the complex or a relation of that lessor, for a period of at least one year or for a shorter period where the next use of the unit after that shorter period is as described in clause (iii)(B), or

(B) as a place of residence of individuals, each of whom is given continuous occupancy of the unit, under one or more leases, for a period, throughout which the unit is used as the primary place of residence of that individual, of at least one year or ending when the unit is sold to a recipient who acquires the unit for use as the primary place of residence of the recipient or of a relation of the recipient, and

(iv) if, at the particular time, the person intends that, after the unit is used as described in clause (iii), the person will occupy it for the person's own use or the person will supply it by way of lease as a place of residence or lodging for an individual who is a relation, shareholder, member or partner of, or not dealing at arm's length with, the person, the person can reasonably expect that the unit will be the primary place of residence of the person or of that individual; or

(*b*) a prescribed residential unit of the person.

"qualifying portion of basic tax content", at a particular time, of property of a person means the amount that would be the basic tax content of the property at that time if that amount were determined without reference to subparagraph (v) of the description of A in the definition "basic tax content" in

subsection 123(1) of the Act and if no amount of tax under any of subsections 165(2), 212.1(2) and 218.1(1) and Division IV.1 of Part IX of the Act that was, or would have been, payable by the person were included in determining that basic tax content.

"relation" has the meaning assigned by subsection 256(1) of the Act.

"self-contained residence" means a residential unit

(*a*) that is a suite or room in a hotel, a motel, an inn, a boarding house or a lodging house or in a residence for students, seniors, individuals with a disability or other individuals; or

(*b*) that contains private kitchen facilities and a private bath and living area.

(22) That a reference, in an enactment founded on any of paragraphs (21) and (23) to (32), to a "lease" be read as a reference to a "lease, licence or similar arrangement".

(23) That, where

(*a*) a particular person, other than a cooperative housing corporation,

(i) is the recipient of a taxable supply by way of sale (referred to as the "purchase from the supplier") from another person of a residential complex or of an interest in a residential complex and is not a builder of the complex, or

(ii) is a builder of a residential complex, or of an addition to a multiple unit residential complex, who makes an exempt supply by way of lease included in section 6 or 6.1 of Part I of Schedule V to the Act that results in the person being deemed under section 191 of the Act to have made and received a taxable supply by way of sale (referred to as the "deemed purchase") of the complex or addition,

(*b*) at a particular time, tax first becomes payable in respect of the purchase from the supplier or tax in respect of the deemed purchase is deemed to have been paid by the person,

(*c*) at the particular time, the residential complex or addition, as the case may be, is a qualifying residential unit of the person or includes one or more qualifying residential units of the

person, and

(*d*) the person is not entitled to include the tax in respect of the purchase from the supplier, or the tax in respect of the deemed purchase, in determining an input tax credit of the person,

the Minister of National Revenue shall, subject to paragraphs (27) and (29), pay a rebate to the person equal to the total of all amounts each of which is an amount, in respect of a residential unit that forms part of the residential complex or addition, as the case may be, and is a qualifying residential unit of the person at the particular time, determined by the formula

$$A \times (\$450{,}000 - B)/\$100{,}000$$

where

A is the lesser of $8,750 and the amount determined by the formula

$$A_1 \times A_2$$

where

A_1 is 36 per cent of the total tax under subsection 165(1) of the Act that is payable in respect of the purchase from the supplier or is deemed to have been paid in respect of the deemed purchase, and

A_2 is

(i) if the unit is a single unit residential complex or a residential condominium unit, 1, and

(ii) in any other case, the unit's percentage of total floor space, and

B is the greater of $350,000 and

(i) if the unit is a single unit residential complex or a residential condominium unit, the fair market value of the unit at the particular time, and

(ii) in any other case, the amount determined by the formula

$$B_1 \times B_2$$

where

B_1 is the unit's percentage of total floor space, and

B_2 is the fair market value at the particular time of the residential complex or addition, as the case may be.

(24) That, where

(*a*) a person, other than a cooperative housing corporation, is a builder of a residential complex or of an addition to a multiple unit residential complex and the person makes

(i) an exempt supply by way of sale, included in section 5.1 of Part I of Schedule V to the Act, of a building or part of a building, and

(ii) an exempt supply, included in section 7 of that Part, of land by way of lease or an exempt supply, included in that section, by way of assignment of a lease in respect of land,

(*b*) the lease provides for continuous possession or use of the land for a period of at least twenty years or it contains an option to purchase the land,

(*c*) those supplies result in the person being deemed under section 191 of the Act to have made and received a taxable supply by way of sale of the complex or addition and to have paid tax at a particular time in respect of that supply,

(*d*) in the case of a multiple unit residential complex or an addition to such a complex, the complex or addition, as the case may be, includes, at the particular time, one or more qualifying residential units of the person,

(*e*) the person is not entitled to include the tax deemed to have been paid by the person in determining an input tax credit of the person, and

(*f*) in the case of an exempt supply by way of sale of a single unit residential complex or a residential condominium unit, the recipient of that supply is entitled to claim a rebate under subsection 254.1(2) of the Act in respect of the complex or unit,

the Minister of National Revenue shall, subject to paragraphs (27) and (29), pay a rebate to the person equal to the total of all amounts each of which is an amount, in respect of a residential unit that forms part of the residential complex or addition, as the case may be, and is, in the case of a multiple unit residential complex or an

addition to such a complex, a qualifying residential unit of the person at the particular time, determined by the formula

$$[A \times (\$450,000 - B)/\$100,000] - C$$

where

A is the lesser of $8,750 and the amount determined by the formula

$$A_1 \times A_2$$

where

A_1 is 36 per cent of the tax under subsection 165(1) of the Act that is deemed to have been paid by the person at the particular time, and

A_2 is

(i) if the unit is a single unit residential complex or a residential condominium unit, 1, and

(ii) in any other case, the unit's percentage of total floor space,

B is the greater of $350,000 and

(i) if the unit is a single unit residential complex or a residential condominium unit, the fair market value of the unit at the particular time, and

(ii) in any other case, the amount determined by the formula

$$B_1 \times B_2$$

where

B_1 is the unit's percentage of total floor space, and

B_2 is the fair market value at the particular time of the residential complex or addition, as the case may be, and

C is the amount of the rebate, if any, under subsection 254.1(2) of the Act that the recipient of the exempt supply by way of sale is entitled to claim in respect of the complex or unit.

(25) That, where

(*a*) a cooperative housing corporation (referred to as the "cooperative")

(i) is the recipient of a taxable supply by way of sale (referred to as the "purchase from the supplier") from another person of

a residential complex or of an interest in a residential complex and is not a builder of the complex, or

(ii) is a builder of a residential complex, or of an addition to a multiple unit residential complex, who makes an exempt supply by way of lease included in section 6 of Part I of Schedule V to the Act that results in the cooperative being deemed under section 191 of the Act to have made and received a taxable supply by way of sale (referred to as the "deemed purchase") of the complex or addition and to have paid tax in respect of that supply,

(*b*) the cooperative is not entitled to include the tax in respect of the purchase from the supplier, or the tax in respect of the deemed purchase, in determining an input tax credit of the cooperative, and

(*c*) at any time at which a residential unit included in the complex is a qualifying residential unit of the cooperative, the cooperative first gives occupancy of the unit after its construction or last substantial renovation under an agreement for a supply of that unit that is an exempt supply included in section 6 of that Part,

the Minister of National Revenue shall, subject to paragraphs (27) and (29), pay a rebate to the cooperative in respect of that unit equal to the amount determined by the formula

$$[A \times (\$450{,}000 - B)/\$100{,}000] - C$$

where

A is the lesser of $8,750 and the amount determined by the formula

$$A_1 \times A_2$$

where

A_1 is 36 per cent of the total tax under subsection 165(1) of the Act that is payable in respect of the purchase from the supplier or is deemed to have been paid in respect of the deemed purchase, and

A_2 is

(i) if the unit is a single unit residential complex, 1, and

(ii) in any other case, the unit's percentage of total floor space,

B is the greater of $350,000 and

(i) if the unit is a single unit residential complex, the fair market value of the unit at the particular time at which tax first becomes payable in respect of the purchase from the supplier or tax in respect of the deemed purchase is deemed to have been paid by the cooperative, and

(ii) in any other case, the amount determined by the formula

$$B_1 \times B_2$$

where

B_1 is the unit's percentage of total floor space, and

B_2 is the fair market value of the unit at the particular time, and

C is

(i) if the recipient of the exempt supply of the unit was entitled to claim a rebate under subsection 255(2) of the Act in respect of the unit, the amount of that rebate, and

(ii) in any other case, nil.

(26) That, where

(*a*) a person makes a supply of land or of an interest in land

(i) that is an exempt supply, included in paragraph 7(*a*) of Part I of Schedule V to the Act, to a person described in subparagraph (i) of that paragraph, or that is an exempt supply, included in paragraph 7(*b*) of that Part, of a site in a residential trailer park, and

(ii) that results in the person being deemed under any of subsections 190(3) to (5), 200(2), 206(4) and 207(1) of the Act to have made and received a taxable supply by way of sale of the land and to have paid tax, at a particular time, in respect of that supply,

(*b*) in the case of an exempt supply of land described in paragraph 7(*a*) of that Part, the residential unit that is or is to be affixed to the land is or will be so affixed for the purpose of

its use and enjoyment as a primary place of residence for individuals, and

(*c*) the person is not entitled to include the tax deemed to have been paid by the person in determining an input tax credit of the person,

the Minister of National Revenue shall, subject to paragraphs (27) and (29), pay a rebate to the person equal to the amount determined by the formula

$$A \times (\$112{,}500 - B) / \$25{,}000$$

where

A is

(i) in the case of a taxable supply in respect of which the person is deemed to have paid tax calculated on the fair market value of the land, 36 per cent of the tax under subsection 165(1) of the Act that is deemed to have been paid in respect of that supply, and

(ii) in the case of a taxable supply in respect of which the person is deemed to have paid tax equal to the basic tax content of the land, 36 per cent of the qualifying portion of the basic tax content of the land at the particular time, and

B is the greater of $87,500 and

(i) in the case of an exempt supply of land included in paragraph 7(*a*) of that Part, the fair market value of the land at the particular time, and

(ii) in the case of an exempt supply of a site in a residential trailer park or in an addition to a residential trailer park, the fair market value, at the particular time, of the park or addition, as the case may be, divided by the total number of sites in the park or addition, as the case may be, at the particular time.

(27) That, in order for a person to be entitled to a rebate in respect of a residential unit under an enactment founded on any of paragraphs (23) to (26),

(*a*) the person be required to file an application for the rebate within two years after

(i) in the case of a rebate under an enactment founded on

paragraph (25), the month in which the person makes the exempt supply of the unit referred to in that paragraph, and

(ii) in any other case, the month in which tax first becomes payable by the person, or is deemed to have been paid by the person, in respect of the unit or the residential complex or addition in which the unit is situated; and

(*b*) where the person received a taxable supply of the unit, or of the complex or addition in which the unit is situated, from another person, the person be required to have paid all of the tax payable in respect of that supply.

(28) That, where the application of a person for a rebate under an enactment founded on any of paragraphs (23) to (26) is required to be filed within two years after a month that ends before the day on which Royal Assent is given to the enactment, the person have until the day that is two years after the day of the assent to file the application.

(29) That no rebate be paid to a person under an enactment founded on any of paragraphs (23) to (26) if all or part of the tax included in determining the rebate would otherwise be included in determining a rebate of the person under any of sections 254, 256, 256.1 and 259 of the Act.

(30) That, where a trust governed by a multi-employer pension plan is entitled to include tax under subsection 165(1) of the Act that was payable or deemed to have been paid by the trust in determining a rebate under an enactment founded on any of paragraphs (23) to (26), the trust not be entitled to include any portion of that tax in determining any multi-employer pension plan rebate to which it may be entitled.

(31) That, for the purposes of an enactment founded on any of paragraphs (21) to (26),

(*a*) where, at any time, substantially all of the residential units in a multiple unit residential complex containing ten or more residential units are units in respect of which the condition set out in the definition of "qualifying residential unit" pertaining to the first use of the unit is satisfied, all of the residential units in the complex be deemed to be units that satisfy that condition at that time;

(*b*) except in the case of residential units referred to in paragraph (*a*) of the definition “self-contained residence”,

(i) the two residential units that are located in a multiple unit residential complex containing only those two residential units be deemed to form a single residential unit, and

(ii) where an area of a building is, or is deemed pursuant to this paragraph to be, all or part of a particular residential unit and occupants of that area have, or will have, direct internal access, with or without restriction, to another area of the building that is all or part of a residential unit, that other area be deemed to be part of the particular residential unit and not to be all or part of any other residential unit; and

(*c*) in determining the rebate of a person under that enactment, there not be included any amount of tax that the person is exempt from paying under an Act of Parliament (other than the *Excise Tax Act*) or any other law.

(32) That, where a person was entitled to claim a rebate under an enactment founded on paragraph (23) in respect of a qualifying residential unit and, within 1 year after the unit is first occupied as a place of residence after its construction or last substantial renovation, the person sells the unit to a purchaser who is not acquiring the unit for use as the primary place of residence of the purchaser or of a relation of the purchaser, the person be required to pay to the Receiver General an amount equal to the rebate, plus interest at the rate prescribed for the purpose of paragraph 280(1)(*b*) of the Act calculated on that amount for the period beginning on the day the rebate was paid or applied to a liability of the person and ending on the day the amount of the rebate is paid by the person to the Receiver General.

(33) That any enactment founded on any of paragraphs (21), (22) and (27) to (32) be deemed to come into force on February 28, 2000.

(34) That any enactment founded on any of paragraphs (23) to (25) apply in respect of residential complexes and additions to residential complexes the construction or substantial renovation of which begins after February 27, 2000 or, in the case of a deemed substantial renovation of a building converted into the residential complex, where the construction or alterations necessary to effect the conversion begins after February 27, 2000.

(35) That any enactment founded on paragraph (26) apply in

respect of exempt supplies of land by way of lease made after February 27, 2000.

Jeopardy Assessment and Collection

(36) That the following definitions be added to Part IX of the Act for the purposes of any enactment founded on this paragraph or any of paragraphs (37) to (49):

"accrued net tax", in respect of a reporting period of a person, on a particular day, means the amount that would be the net tax for the period if,

(*a*) on that day, the person were to claim in a return under Division V of Part IX of the Act filed for the period all amounts, each of which is an amount that the person would be entitled on that day to claim as an input tax credit for the period or as an amount that may be deducted by the person in determining the net tax for the period; and

(*b*) where the period includes the particular day, that day were the last day of the period.

"assessed period", in respect of an authorization referred to in paragraph (37) relating to a particular reporting period of a person, means

(*a*) if the hearing date is before the end of the particular reporting period, the period beginning on the first day of the particular reporting period and ending on the assessment date; and

(*b*) in any other case, the particular reporting period.

"assessment date", in respect of an authorization referred to in paragraph (37), means the day immediately before the hearing date.

"hearing date", in respect of an authorization referred to in paragraph (37), means the day on which a judge hears the application for the authorization.

"judge" means a judge of a superior court of a province or a judge of the Federal Court.

(37) That, where, on *ex parte* application by the Minister of National Revenue relating to a particular reporting period of

a person, a judge is satisfied that there are reasonable grounds to believe that the net tax for the period, determined without reference to any enactment founded on paragraph (38), will be a positive amount and that the collection of all or any part of that net tax would be jeopardized by a delay in its collection, the judge shall, on such terms as the judge considers reasonable in the circumstances, authorize the Minister to, without delay,

(*a*) assess the net tax, determined in accordance with an enactment founded on paragraph (38), for the assessed period; and

(*b*) take any of the actions described in sections 316 to 321 of the Act for the recovery of that amount.

(38) That, for the purposes of Part IX of the Act, where an authorization referred to in paragraph (37) is granted in respect of an application relating to a particular reporting period of a person,

(*a*) if the hearing date is before the end of the particular reporting period,

(i) each of the following periods be deemed to be a separate reporting period of the person:

(A) the period beginning on the first day of the particular reporting period and ending on the assessment date, and

(B) the period beginning on the hearing date and ending on

(I) if the particular reporting period is a fiscal year, the last day of the fiscal quarter that includes the hearing date, and

(II) in any other case, the last day of the particular reporting period, and

(ii) the reporting period of the person beginning after the hearing date be determined to be the fiscal quarter of the person unless the person had elected to have reporting periods that are fiscal months;

(*b*) the due date for the person's return under Division V of Part IX of the Act for the assessed period be deemed to be the hearing date;

(*c*) the net tax for the assessed period be deemed to be equal to the accrued net tax in respect of the particular reporting period on the assessment date and that amount be deemed to have become due to the Receiver General on the hearing date;

(*d*) if, in determining that accrued net tax, the Minister of National Revenue takes into account an amount as an input tax credit or a deduction from net tax, the person be deemed to have claimed the amount in a return under Division V of Part IX of the Act filed for the assessed period; and

(*e*) any penalty and interest under section 280 of the Act, and any penalty under section 284 of the Act, be determined as if the net tax for the assessed period were not required to be remitted, and the return for the assessed period were not required to be filed, until the last day of the period described in paragraph (44).

(39) That statements contained in an affidavit filed in the context of an application under an enactment founded on any of paragraphs (37), (42), (43) and (45) be allowed to be based on belief with the grounds for that belief.

(40) That an authorization referred to in paragraph (37) in respect of a person be required to be served by the Minister of National Revenue on the person within 72 hours after it is granted, except where the judge orders the authorization to be served at some other time specified in the authorization, and a notice of assessment for the assessed period be required to be served on the person together with the authorization.

(41) That, for the purposes of an enactment founded on paragraph (40), service on a person be required to be effected by

(*a*) personal service on the person; or

(*b*) service in accordance with directions, if any, of a judge.

(42) That, where service cannot reasonably be otherwise effected as and when required under an enactment founded on paragraph (41), the Minister of National Revenue be allowed to, as soon as practicable, apply to a judge for further direction.

(43) That, where a judge of a court has granted an authorization under any enactment founded on paragraph (37) in respect of a person, the person be allowed to apply, on 6 clear days' notice to the Deputy Attorney General of Canada, to a judge of the court to review the authorization.

(44) An application by a person under an enactment founded on paragraph (43) to review an authorization be required to be made

(*a*) within 30 days from the day on which the authorization was served on the person; or

(*b*) within such further time as a judge may allow, on being satisfied that the application was made as soon as practicable.

(45) That an application by a person under an enactment founded on paragraph (43) be allowed to be heard *in camera*, if the person applies therefore and establishes to the satisfaction of the judge that the circumstances of the case justify *in camera* proceedings.

(46) That, on an application under an enactment founded on paragraph (43), the judge shall determine the question summarily and may confirm, vary or set aside the authorization and make such other order as the judge considers appropriate.

(47) That, where an authorization is set aside under an enactment founded on paragraph (46), any enactment founded on paragraph (38) not apply in respect of the authorization and any assessment made pursuant to the authorization be deemed to be void.

(48) That, where any question arises as to the course to be followed in connection with anything done or being done under an enactment founded on any of paragraphs (37) to (47) and there is no relevant direction in the enactment, a judge may give such direction with regard to the course to be followed as, in the opinion of the judge, is appropriate.

(49) That no appeal lie from an order of a judge referred to in paragraph (46).

(50) That any enactment founded on any of paragraphs (36) to (49) come into force on Royal Assent.

Provision of Information to Police

(51) That section 295 of the Act be amended to permit an official to provide confidential information to a police officer, as defined by subsection 462.48(17) of the *Criminal Code*, where

(*a*) an official has performed or is performing an act that Part IX of the Act obliges or authorizes the official to perform;

(*b*) the information can reasonably be regarded as necessary to ascertain the identity of a person and the circumstances in which an offence, which may reasonably be considered to be related to that act, may have been committed under the *Criminal Code* by the person in respect of an official of the Canada Customs and Revenue Agency, or a provincial official authorized to exercise duties and powers under Part IX of the Act pursuant to an administration agreement between the government of the province and the government of Canada, or in respect of any person related to the official; and

(*c*) the information is provided solely for the purpose of the investigation or prosecution of the offence.

Hindering a Tax Official

(52) That the prohibitions and obligations under subsection 231.5(2) of the *Income Tax Act* imposed on a person in relation to administrative and enforcement acts authorized under that Act be paralleled with respect to the comparable administrative and enforcement acts authorized under the *Excise Tax Act*, and the penalty under section 238 of the *Income Tax Act* for failure to comply with those prohibitions and obligations likewise be paralleled in the *Excise Tax Act*.

Excise Tax on Tobacco Exports

(53) That the annual exemption from the excise tax on exports of tobacco products by a manufacturer be reduced for each category of tobacco product from 2.5 per cent to 1.5 per cent of the manufacturer's total production of that category of tobacco product in the previous calendar year, effective for tobacco products exported after March 2000, and pro-rated for the 2000 transitional year.

Notice of Ways and Means Motion to Amend the *Customs Act*

That it is expedient to amend the *Customs Act* to provide among other things:

Hindering an Official

(1) That the prohibitions and obligations under subsection 231.5(2) of the *Income Tax Act* imposed on a person in relation to administrative and enforcement acts authorized under that Act be paralleled with respect to the comparable administrative and enforcement acts authorized under the *Customs Act*, and the penalty under section 238 of the *Income Tax Act* for failure to comply with those prohibitions and obligations likewise be paralleled in the *Customs Act*.

Notice of Ways and Means Motion to Amend the *Special Import Measures Act*

That it is expedient to amend the *Special Import Measures Act* to repeal, or suspend the operation of, certain provisions in that Act for the purpose of bringing it into conformity with recent changes to the World Trade Organization Agreement on Subsidies and Countervailing Measures, including any necessary related amendments.